The Morals of Monopoly and Competition

REED

The Morals of Monopoly and Competition

BY

HOMER BLOSSER REED, Ph. D.

ASSISTANT PROFESSOR OF PSYCHOLOGY AND PHILOSOPHY

UNIVERSITY OF IDAHO

The Collegiate Press

George Banta Publishing Company

Menasha, Wisconsin

1916

PREFACE

This little book was begun in connection with a Seminar in the Ethics of Business under Professor James H. Tufts of the University of Chicago, and was written during the spring and summer of 1912. In publishing it at this delayed date, the author did not undertake to make a revision for the reason that the principles in question have not changed and are more vital than ever. Much progress has however been made in the solution of the problems of monopoly and competition and many sources regarding the methods of competition have come to light since 1912. However, the various papers on the Federal Trade Commission and its Problems in the Annals of the American Academy of Political and Social Science, January, 1916, review these sufficiently and should be read in connection with this book. A word, however, may be said with reference to the Clayton Act and the Federal Trade Commission Act which embody the important legislation made since 1912 upon the problem in question. The Clayton Act, among other things, forbids price discrimination, rebating on merchandise, and making the sale of a monopolistic article conditional upon the sale of other articles, where the effect may be "to substantially lessen competition or tend to create a monopoly." The Federal Trade Commission Act forbids "unfair methods of competition" and empowers the Commission to bring a proceeding against a corporation using an unfair method of competition "if it shall appear that a proceeding by it in respect thereof would be to the interest of the public." It is not stated, however, what the meaning is of these phrases: "to substantially lessen competition," "to tend to create a monopoly," "unfair competition" or "the interest of the public." Evidently there is room here for judicial interpretation. By what method shall a judge settle these questions? Shall he merely consider what has been laid down by the law in the past or shall he study each case with reference to its facts and with reference to the future public good? It is in cases of this sort that a judge should be conscious of his *logic*, a matter in which it is hoped this book may be found of some use. While it is dissappointing to find so much undefined in these Acts, it is a matter of congratulation to see that they have made a great step forward in putting big business under the public law and under the direction of public experts, which means that the purpose of these Acts and the purpose of this book grew out of common objective conditions.

I gratefully acknowledge my indebtedness to Professor Tufts who read the manuscript a number of times and offered many helpful criticisims and suggestions; to Professors Geo. H. Mead, E. S. Ames, R. F. Hoxie, T. C. Marshall, and C. W. Wright,—all of whom gave the manuscript a critical reading; and to Anna Dale C. Reed, who kindly did the typing and proofreading.

H. B. R.

Moscow, Idaho, March, 1916.

CONTENTS

CHAPTER I

Introductory

That a change in business practices and morals is taking place, is evident from the opinions of judges, legislators, and business men alike. For example, President Havemeyer of the American Sugar Refining Company stated well the old competitive morality in his testimony before the Industrial Commission in 1900. He was asked whether it was a fair ethical proposition to make consumers pay dividends on an over-capitalization of $25,000,000. He answers: "I think it is fair to get out of the consumer all you can, consistent with the business proposition. . . . I do not care two cents for your ethics. I do not know enough of them to apply them. . . . If you get too much of a profit, you get somebody in competition."[1]

In 1889, Andrew Carnegie wrote in a similar style: "It is not in the power of man to exact for more than a brief season, indeed, unusual profit upon capital invested, either in transportation or manufacture, so long as all are free to compete, and this freedom, it may safely be asserted, the American people are not likely to restrict."[2] But before the congressional committee investigating the United States Steel Corporation, he presented a statement that shows a decided change of opinion: "Your task," he says, "arises from the fact that the law of competition in business, which prevailed generally and operated with tolerable efficiency,

[1] Report of Industrial Commission, Vol. I, p. 118.

[2] *North American Review*, Feb., 1889.

has seemed recently to be impaired in certain fields, notably those of oil, steel, and tobacco. . . . . I assume that it may be laid down as an axiom that where practical monopoly exists through combination in any industrial field or in any natural product, regulation under law must follow to avert the grave danger of extortion from the consumer . . . search the civilized world around, we find the invariable rule that a judge personally interested in the slightest degree in a cause is thereby debarred from sitting in judgment upon it. . . . Producers, from the nature of the case, are thus debarred from sitting in judgment. Nor can their representations of desire to obtain only "fair prices" and "no monopoly" be accepted as conclusive . . . there should promptly be created an industrial court, molded after the Interstate Commerce Commission, charged with all questions connected with manufacture and natural products. . . . Its province should be to examine all details, ascertain cost of production, adding to such as in its judgment will yield a fair or liberal return upon capital when skillfully invested and properly managed; the maximum selling price to be fixed by the court, based upon the average cost price of product in up-to-date, well managed works."[3]

Here then we have an example showing very clearly that the autonomous justice of the old-fashioned competitive system no more applies to conditions of monopoly, which require regulation by the government. Beside Mr. Carnegie, many others expressed similar

[3] Hearings, Jan. 10, 1912, pp. 2346-47.

views, notably Judge Gary and Mr. Perkins of the United States Steel Corporation.

What has brought about this change of opinion? It was the logic of the competitive principles themselves. Under the competitive system, a trader was under no obligation to treat all alike. He could sell at any price he could get—could either give his goods away or charge as many different prices as he pleased. He could give rebates whenever and to whomever he pleased, or cut prices to any extent on his competitor, and even untruthfully praise the merits of his own goods. The system was not so bad as applied to individual traders since they were all about equal in strength, and it was a game therefore which two could play, one man's error being corrected by another. The system worked badly, however, when too many traders engaged in one industry, causing competition to be so sharp that hardly any could make satisfactory headway. The trader remedied this evil by combination. The combination, as well as the courts, took it for granted that whatever an individual could lawfully do a combination of individuals might lawfully do. The combination therefore carried on the same methods and practices as the competitive individual traders. Because of his small capital, the individual could not meet the rebates and the cut-prices of the combination, no matter how good a manager or producer he was. The autonomous corrective of competition was lost, resulting in a monopoly to the combination which exploited both the individual trader and the consumer. After the damage was done, people began to see the wrong of the combination's doing business in the same way as the competitive individual trader. But it took a long time to see the wrong, and a still longer time to remedy it. The evil of rebates, for example, was pointed out very fully by the oil producers as early as 1872. The railroads also understood it, for in that year the trunk lines made an agreement with the Producers' Union to treat all equally and not give one shipper the slightest advantage over another. The following year, Beasley, C. J., in a well reasoned case[4] pointed out the evils and results of rebates as clearly as they have ever been pointed out. The public as a whole, however, did not understand it, and it required twenty years to get a law passed condemning rebates, and twenty years more to put it in force. The problem of railroad rebates has now been fairly solved through the action of the Interstate Commerce Commission. But the public is not yet convinced that the industrial problem requires a similar solution.

There are many reasons why the public and the government were so slow in recognizing and remedying the evils of rebates and other competitive practices considered bad. When the industrial revolution began in the United States, after the Civil War, there was a vast new country rich in possible wealth to be developed, and people had to get things done, no matter how. They were interested in results—railroads, factories, and steamboats—and in means only so far as they produced the desired results. They wanted promoters rather than preachers. They had no time to reflect

[4] *Messenger et al v. Pennsylvania R. R. Co.*, 36 N. J., 407.

over the ethical character of the means nor to reconstruct their acquired habits to satisfactorily meet the changing conditions. The age was absorbed in economic development, while the ethical lagged behind. For example, when the Union Pacific line was completed across the western continent, Bancroft says: "The last tie . . . was placed beneath the connecting ends of the rails, and a spike of gold, placed in a cavity to receive it, was driven home by a silver hammer in the hands of President Stanford of the Central Pacific. . . . Congratulatory telegrams were read from cities east and west . . . cheers, music, and banqueting followed, and the royal marriage was consumated. . . . Thus ended in fulfillment the long dream of nearly forty years, a fulfillment that was celebrated in every city of the North and many of the South with enthusiasm."[5] The moral judgment of the public did not change until four years afterwards, when some began to complain of its methods of construction and instituted a Congressional investigation. When the evidence was revealed, the construction company, the Credit Mobilier, was marked "the King of Frauds" and two members of Congress, Oakes Ames and James Brooks, promoters of the railway who distributed some stock among Congressmen for securing "friends" and favorable legislation, were dismissed from Congress, thus appeasing public clamor by making the two most convenient victims scapegoats of the entire affair. Both men were undoubtedly unaware of having employed questionable methods, as they were building a railroad

[5] *Works*, Vol. 24, p. 575.

just as other men would build it, and adopting such means as would bring success under the existing conditions.

The Union Pacific incident furnishes a typical example of the way in which morals and law lagged behind the industrial development. This lagging was aggravated on the one hand by the general demoralization from the Civil War, and on the other, by the *laissez faire* policy of the government necessitated in part by the period of Reconstruction that followed the war. The period during and after the Civil War was not noted for its high business morals. Traders had to turn the fortunes of war to their enrichment. In one case, 5,000 rifles in the New York Armory, condemned by the army officers, were bought from the government at \$3.50 apiece and sold to Gen. Fremont[6] in St. Louis for "new" and "government standard" at \$22.00 apiece. A quotation from *The Book of Daniel Drew* will give the moral setting of the time. "I saw very quickly," says Drew, "that the War of the Rebellion was a money maker for me. Along with ordinary happenings, we fellows in Wall Street now had in addition the fortunes of war to speckilate about and that always makes great doings on a stock exchange. . . . As I look back now, I see that I never made more money, or had four years that were in all respects more genuinely prosperous. . . . We financial men organized a way of getting early news from the seat of war. A silver key will open any lock. We had on our pay roll, sutlers, reporters, private soldiers, and officers even

[6] *Rep. of Committees, 37th Congress, 2nd Sess.*, Vol. II, p. LXVII.

up to generals. . . . Big officials who wouldn't accept money could usually be reached by giving them some shares in the stock we were manipulating. (We didn't dare make offers of this kind to Abe himself. Lincoln was an impractical man, so far as money making went. All he thought about was to save the Union. . . .) During these days of the War, we who were on the inside could call the turn of a stock long before the general public. This made very profitable business. In fact, I got to taking a great deal of interest in the Boys in Blue. . . . When Richmond was finally taken, I for one was sorry to have the War come to an end."[7] It is significant that many of our late and present masters of industry and finance were young men receiving their education in this situation described by Drew.

The *laissez faire* policy was scarcely a less hindrance to morals and legal development than the condition described by Drew. Although the period of Reconstruction made it impossible for the government to superintend business, yet this period was over before the industrial problem became serious. The Sherman Act was passed in 1890, indicating that Congress perceived the error of the *laissez faire* policy and now demanded governmental action. But the Supreme Court was not yet converted. Four years later, when the Attorney General brought suit for dissolving the American Sugar Refining Company, Chief Justice Fuller said: "It is vital that the independence of the commercial power and of the police power, and the

[7] *Book of Daniel Drew*, edited by B. W. White, pp. 160-162.

delimitation between them . . . should always be recognized . . .; and acknowledged evils, however grave and urgent they may appear to be, had better be borne than the risk be run, in the effort to suppress them, of more serious consequences by resort to expedients of even doubtful consitutionality."[8] Under such an opinion, industrial combinations had nothing to fear, and it was not until the Addyston Pipe & Steel Company case, tried five years later, that a change of attitude was evident. "We conclude," Justice Peckham said, "that the plain language of the grant to Congress of power to regulate commerce among the several states includes power to legislate upon the subject of those contracts in respect to interstate or foreign commerce which directly affect and regulate that commerce, and we can find no reasonable ground for asserting that the constitutional provision as to the liberty of the individual limits the extent of that power as claimed by the appellants."[9] With this decision the much prolonged policy of *laissez faire* had its natural death. Whether this opinion was delivered too late to remedy the evils for which it was intended is not yet determined. But it cannot be denied that *laissez faire* greatly hindered the legal development from keeping pace with the economic.

Considering then the absorbent interest created in economic affairs by the rapid industrial development, the lax morals resulting from the Civil War, and the *laissez faire* policy of the government, it is no wonder

[8] *United States v. E. C. Knight Co.*, 156 U. S., 1, 13.

[9] 175 U. S., 211, 235.

that ethical evolution did not develop equally with the economic, and that the old morals of individual competition were applied without question to conditions of combination. It is this unequal evolution[10] between the spheres of morals and industry that accounts for the serious problem existing to-day in the world of business.

This evolution is now taking place in the business world, and one of the outstanding features of this evolution is the change from private and competitive morality to public and coöperative morality. To understand the character of this change at least three things are necessary. First we must know why private and competitive morality in big business fails to satisfy the modern public. We must understand what results that morality has produced which the public has pronounced bad and for which it demands a remedy. Second, we must know something of the solutions that have been proposed to remedy these so-called evils. And third, we must submit these to a critical analysis, and develop such new principles as seem to be required by a fresh analysis of changing conditions.

The change from private to public morals in business first began with the railroads. In the early days of the railroads, private bargains between shipper and carrier were no more thought of than a private deal between a consumer and a shoemaker. But after a time it was discovered that the favored shipper was getting an

[10] See *Morals in Modern Business*, Page Lecture Series, Yale University, Chapter on *Morals of Trade in the Making*, E. D. Page, 1909 p. 10-12.

unusual advantage, and then a cry was raised against rebates, a practice which it took forty years to eliminate. But the result was that the railroads were brought under the public law and then the courts had the obligation of developing a principle by which they might determine the fairness of the rate charges of these public carriers, a task which was much more difficult than the elimination of rebates. Now, the legal development by which the railroads were changed from private to public law is one of the interesting chapters in the evolution of morals, and it is just as intricate as it is interesting. But it is not only interesting from the standpoint of evolution but from a practical standpoint as well, for the change from private to public law in case of our large industrial corporations is bound to take the same course. The history of the change from private to public law in the case of carriers therefore provides the best suggestion for the solution of our modern industrial problem.

It shall be the purpose of this essay to trace this development in the case of carriers, and then to take a similar task in connection with large industrial corporations in so far as this is possible under present conditions. In general, our mode of treatment will be to describe, first the results produced by the practice of private morality between carriers and shippers; second, to describe the solution proposed for these practices (and these will be taken from the court decisions for it was in the courts that the problem was fought out); and third, to set forth through a criticism of these court decisions the new principles that were developed for the purpose of meeting the conditions of modern society. Having finished with the carriers, we shall take up a similar mode of treatment for large industrial corporations. Those interested only in the conclusions reached may turn to the summary at the end of the essay.

CHAPTER II

The Change from Private to Public Morals with Carriers

In the previous chapter, I indicated that my general plan would be to describe concretely the results of applying the methods of private and competitive business to public and monopolistic business, or, in other words, the results of applying the methods of individual traders in competition to conditions of combination, then to review judicial opinion upon the justness of such an application, and finally, by critical examination to interpret and justify the new principles required by conditions of monopoly and combination, the business of which is public in character.

In this chapter I shall describe the effect upon shippers when railroads base their rates upon the competitive principle of charging what the traffic will bear. Then I shall review judicial opinion upon rate discrimination, and, finally, I shall show how the character of the railroad business demanded the cost-of-service principle.

Section I. *The Effect of Private Bargaining between Railroads and Shippers.*

Charging what the traffic will bear generally means a special rate between the railroad and the individual shipper. If the shipper is small and has not the advantage of competition, his traffic will bear a high rate. If the shipper is large and has the advantage of competition, his traffic will not bear a high rate. In the past, this generally meant that the carrier gave the large shipper a rebate in order to get his business; or, if he did not give a rebate, he made some other sort of discrimination. It is necessary to see that charging what the traffic will bear is a principle allowing such discrimination between individual shippers. To understand the working of such a principle in the railroad business, it is necessary only to describe what rate discriminations have meant to the favored shipper. The history of the American Sugar Refining Company, or of the Chicago packing houses, or of the Carnegie Steel Company, would all furnish examples, but the best illustration is supplied by the history of the Standard Oil Company because it has had the benefit of many investigations and the sources for materials are therefore numerous and easily accessible. They are also of a character to supply sufficient data for drawing conclusions. For these reasons, I shall describe briefly what rebates have meant to the Standard Oil Company and to its competitors. Although knowledge of Standard rebates is more or less common, yet their exact and precise effects have never been clearly depicted, and such a task is necessary in order to supply a background for our discussion.

By way of preface, I may state that the Standard owed its monopoly not to the fact that it could manufacture oil more cheaply than its competitors, nor to the fact that it was satisfied with smaller profits, but principally to the fact that it received special privileges in transportation. How it accomplished this I will describe.

Rebates aided the progress of the Standard Oil Company from the beginning, in 1870. In that year, the Lake Shore road granted it a special rate of $1.30 a barrel from Cleveland to New York, the regular rate being at that time $2.00[1] John D. Rockefeller testified before the United States Industrial Commission in 1899 that, at this early period, it was customary for each shipper to make his own special bargains with the railroads. The Standard being a large shipper and having the opportunity of playing competing railroads against each other, as well as having a cheap water route, naturally made good bargains.[2] In this period, there were drawn up the most remarkable rebating contracts in history, the South Improvement Company contracts of 1872. The South Improvement Company purported to represent two-thirds[3]-[4] of the refining capacity of the United States at that time, and in its stock the directors of the Standard Oil Company held the largest interest. In order to further the development of the oil business, this company concluded identical, but separate, contracts with the Pennsylvania, the New York Central, and the Erie railroads, for the transportation of oil. The roads agreed to haul crude oil from the oil regions in western Pennsylvania to

[1] Tarbell, *History of the Standard Oil Co.*, Vol. I, p. 278.

[2] *Ibid.*, Vol. I, p. 795.

[3] *Standard Oil Co. v. U. S.*, Emery, Record, Vol. 6, p. 2623. (Hereafter referred to as Record 6/2623.

[4] Record, Petition, 1/4.

either Cleveland or Pittsburg for 80 cents a barrel and a rebate of 40 cents, to New York for $2.56, and to Philadelphia and Baltimore for $2.41 a barrel, with a rebate of $1.06 a barrel to each point. Refined oil they agreed to haul from Cleveland or Pittsburgh to New York for $2.00, and to Philadelphia or Baltimore for $1.85 a barrel, with a rebate of 50 cents a barrel to each point. From the oil regions to New York the rate was $2.92, and to Philadelphia it was $2.77 a barrel, with a rebate of $1.32 a barrel to each point. The rebates were to be paid to the South Improvement Company alone and all others were to pay the regular tariff. If any one else should be charged a less rate than the regular tariff, the rate to the South Improvement Company was to be reduced an equal amount. Moreover, the rebates were to be paid not only on the South Improvement Company's shipments but on all oil shipments from whatever source. So if the independent in Oil City shipped a consignment of refined oil to Philadelphia, he had to pay $2.77 a barrel to the railroad and the latter paid $1.32 of this sum to the South Improvement Company. The contracts further provided that, "the party hereto of the second part shall maintain the business of the party hereto of the first part against loss or injury by competition, to the end that the party hereto of the first part may keep up a remunerative and so a full and regular business, and to that end shall lower or raise the gross rates of transportation over its railroads and connections. . . . for such times and to such extent as may be necessary to overcome such competition, the rebates and drawbacks to the party of the first part to be varied *pari passu* with the gross rates." "Party hereto of the second part" was the railroad and "party hereto of the first part" was the South Improvement Company.

It is important to keep this clause vividly in mind,[5] not because of its importance to the South Improvement Company, which was quite a transitory concern, but because it gives a hint of the secret of the later success of the Standard Oil Company, which soon became "party hereto of the first part" while the railroads continued to be "party of the second part" and carried out the agreement to all practical purposes.

After the above contracts were concluded, the officers of the Standard Oil Company at once proceeded to make use of them. They went around to the independents in Cleveland in an effort to buy them out, using this forceful argument: "If you don't sell your property to us, it will be valueless for we have gotten advantages with the railroads."[6] After presenting the contracts showing the "advantages," they were able to buy out 25 of the thirty independents in Cleveland at that time. These purchases increased the refining capacity of the Standard from 600 to 10,000 or 12,000 barrels per day, making it by far the largest refining company in the United States. The Standard could now supply a large enough freight traffic to be able to make its own terms with the railroads, and from this time on its interest and that of the railroads became

[5] See Record A/Exhibit 2, for copy of contract.

[6] F. Rockefeller, *Rep. of U. S. Industrial Commission*, Vol. I, p. 64. Hereafter referred to as R. I. C., 64.

identical. This was the benefit the Standard derived from the rebating contracts made by the South Improvement Company with the railroads.

As soon as the terms of the contract became public, it raised such enormous opposition among all oil producers that they speedily compelled its cancellation. Besides, they organized a Producers' Union which, on March 25, 1872, concluded a more favorable contract for rates with the railroads. This contract provided that all shipping of oil should be made on a basis of perfect equality to all shippers, producers, and refiners, and that no rebates, drawbacks, or other arrangements of any kind should be made or allowed that would give any party the slightest advantage in rates, or discrimination of any character whatever.[7] This was a praiseworthy standard indeed, but it proved altogether *too* high for many of the interested parties;[8] for, in less than two weeks afterwards, the New York Central again paid rebates to the Standard Oil Company on its eastbound shipments, a rebate of 25 cents at first but, later, it was increased to 45 cents because of the competition of the Pennsylvania. The railroads did not keep this agreement because to do so would have meant a loss of much of their accustomed traffic.[9] They had agreed to make the rates on oil equal to all refiners, whether in the oil regions or in Pittsburgh or in Cleveland, the rate being $1.50 a barrel to New York and $1.35 to Philadelphia or Baltimore. This seems gen-

[7] 1 R. I. C., 640.

[8] *Ibid.*

[9] *Railroad Investigation*, 1879, New York, Blanchard, p. 3393.

erous to Cleveland and Pittsburgh, since both points were a considerable distance farther from the seaboard than the oil regions were. But the refiners in Cleveland and Pittsburgh had to pay 50 cents a barrel to get their crude oil from the wells. The refiners at the wells, of course, were free from this charge. Its payment would have meant a great loss to the vested interests in those cities; this the railroad wished to avoid, although the arrangement allowed each point its natural advantages of location.

After making use of the South Improvement Company's contracts, the next important step taken by the Standard was to secure control of the oil terminals at New York Harbor belonging to the Erie and the New York Central railroads. It leased the Erie terminal in 1874 and, the next year, entered into a contract with the New York Central for constructing one for it.[10] Each of these contracts was renewed one year after the first signing. They authorized the Standard to make terminal charges upon all oil shipped over these two roads, but to make them no higher than those of competing terminals, which was an equitable provision, but was insignificant since at that time there was but one competing terminal, and that was soon purchased by the Standard. The contract with the Erie stipulated in particular that rates upon oil were to be made between the Standard and the Erie, contrary to the usual custom of railroads making their own rates. The renewed contracts openly allowed the Standard a re-

[10] Record, A/Exhibits 4-5.

bate of 10 per cent from the regular rates.[11] This was given as a compensation for its operating the terminal. Whether this was a fair compensation is not necessary to say. The point is that the rebate, together with the privilege the Standard had of fixing the terminal charges as it pleased, put it above competition. Besides, this arrangement put the Standard in a position to get an exact knowledge of all the business of its competitors shipping over these roads. However, the competitors shipped very little oil. They could not do so because of the prohibitive terminal charges.[12]

Because of its control of the Erie and New York Central terminals, the Standard was well on the way to a monopoly. It required only a few more finishing touches. These were added contemporaneously with the acquirement of the terminals. One of them was the pool of 1874, entered into by the Pennsylvania, New York Central, and Erie railroads. This pool did away with the charges for the hauling of crude oil from the wells to the refinery, as provided in the agreement of 1872 with the Producers Union; and it charged all refiners the same, irrespective of location, for having the oil hauled to the seaboard.[13] The refiners in the oil regions, however, did not see the equity of this arrangement since they were deprived of their

[11] But at the same time the Pennsylvania agreed to pay the Standard a 10% rebate, apparently to guarantee it a certain portion of its business. Blanchard, *Railroad Investigation*, p. 3451.

[12] Emery Record, 6/2640.

[13] Record, A/Exhibit 6.

natural advantages of location; but the refiners in Cleveland or Pittsburgh enjoyed their natural advantages of location for shipping and marketing, and could secure acids, barrels, and other materials needed in refining oil much cheaper than the refiners in the oil regions. But this agreement was much more favorable to the Standard than the competitors supposed; for a short time previous to the pool, the Standard had bought up the leading refineries in Pittsburgh, Philadelphia, and New York, and now owned 90 per cent of the refining capacity of the United States.[14]

However the offensive part in the pool arrangement was a clause providing a rebate of 22 cents a barrel to all shippers who transported their oil "through pipes the owners of which maintain agreed rates of pipage."[15] The "owners" were the United Pipe Lines Company, owned by the Standard Oil Company. This rebate enabled the United Pipe Lines to pay the producers that much more for their oil and so take the trade away from the competing lines. The result was that they increased their pipage from 25 to 80 per cent of the total then existing, at least 12 of the 20 competitors having been forced to sell out.[16]

This pool of 1874 not only forced competitors out of the pipe line business, but it also was equally disastrous to independent refiners. Emery, an importan competitor at that time, said it meant the destruction of the entire independent interests. It shut down every

[14] Record, Petitioners' Brief, Vol. 1, p. 46.

[15] Record, A/Exhibit 6.

[16] Patterson, Railroad Investigation, p. 1693.

refinery along Oil Creek, throwing out of employment over 400 men in the town of Titusville alone. Independents in Pittsburgh and Philadelphia were also either compelled to sell or lease to the Standard.[17]

To escape the prohibitive tariffs of 1874, the independents who yet remained sought routes of transportation. "Dr." Hostetter built the Conduit Pipe Line from near Titusville to Pittsburgh, where it made connection with the Baltimore and Ohio. This line was popularly known as "Hostetter's Bitters Line," because, before the value of crude oil for illuminating purposes became known, "Dr." Hostetter had made a considerable fortune in bottling it and selling it as a patent medicine having many wonderful curative powers. The pipe line had to cross the line of the Pennsylvania, which was not anxious for the competition of the Baltimore and Ohio and therefore did not permit the line to cross. Accordingly "Dr." Hostetter erected tank stations on each side of the tracks and carted the oil across.[18]

A second route chosen by the independents was to ship the oil down the Allegheny River in barges to Pittsburgh, thence down the Ohio to Huntington, West Virginia, from where it went by rail to Richmond, and then by ship to New York or Europe.[19] Although this route increased the distance by several hundred miles, yet it proved much cheaper than the tariffs of the pool of 1874.

[17] Record, 6/2635, 2726.

[18] Emery, Record, 6/648.

[19] Cassat, Record, 20/38.

By the fall of 1874 the Standard Oil Company had control of 90 per cent of the refining capacity of the United States; yet some competitors were arising, the most formidable of which was the Empire Transportation Company, an ally of the Pennsylvania Railroad. This company was thoroughly equipped for transporting and handling oil. It operated 500 miles of pipe, had refineries in Philadelphia and New York, and owned an excellent terminal for handling oil at Communipaw, N. J., on New York Harbor. The Standard objected to this alliance between the Empire and the Pennsylvania, because, since the Standard was primarily a manufacturer and not a carrier, it was not fair for the Pennsylvania, which was a carrier, to engage in competition in manufacturing.[20] The New York Central and the Erie also objected because if the Pennsylvania engaged in manufacturing it would discriminate in its own favor and so take their oil traffic away. Thus the other roads could not meet the competition of the Pennsylvania as a carrier and the Standard could not compete with it as a manufacturer, since the Pennsylvania could transport its oil at a much less cost and so refine oil more cheaply than the Standard. From the standpoint of public policy the objection of the Standard had much in its favor. If all manufacturers entered the carrying business, there would be an excess of carriers, if all carriers entered manufacturing, there would be an excess of manufacturers. Moreover, if these functions were combined in one company, that

[20] Record, Rockefeller, 16/3087; Cassat, 20, 123; Archbold, 6/3252.

company would certainly have the upper hand over those which were carriers alone or manufacturers alone, and so have an easy road to monopoly. Therefore, in a competitive society, there is every reason for keeping the functions of carrier and producer under separate and independent control. The Standard, then, had apparently sound argument from an economic point of view, and also from a business standpoint; since a corporation having the capital of the Pennsylvania, and the right of eminent domain in addition, might prove an unpleasant competitor indeed if allowed to continue. But the political and economic argument of the Standard loses its weight when we recall that at the time of its objection it controlled the terminals of two trunk lines and operated quite a number of miles of pipe line. However, these facts were not generally known and made no difference. The New York Central and the Erie roads in conjunction with the Standard declared hostilities against the Empire and Pennsylvania in March, 1887. The roads fought by cutting rates and the Standard by taking away every bit of its traffic from the Pennsylvania and everywhere underselling the Empire in its markets. By the following October, the Pennsylvania agreed it was primarily a carrier and not a producer and sold the Empire to the Standard, which by this purchase acquired 500 more miles of pipe line and also the Pennsylvania oil terminal at Communipaw.[21] It had now seemingly forgotten the unfairness of combining the functions of carrier and manufacturer in one company. The Penn-

[21] *Railroad Investigation*, Patterson, p. 1995.

sylvania having been brought into line, the three trunk lines conspired to set upon the Baltimore and Ohio. The latter was soon forced to come to terms, and its feeder, the "Hostetter's Bitters Line," also was turned over to the Standard, which promptly put in a connecting pipe underneath the Pennsylvania tracks.

The way was now open to a treaty of peace. Therefore, the four trunk lines arranged a pool in October 17, 1877. The Pennsylvania was to have 47 per cent of the Standard's business with a minimum of two million barrels a year; the New York Central and the Erie rail roads were to have 21 per cent each; and the Baltimore and Ohio 11 per cent. As a reward to the Standard for having made this division properly, the railroads agreed to pay it a rebate of 10 per cent on all its traffic received.[22] Assuming that the Pennsylvania received for shipment its prescribed quantity and the other railroads their proportionate amounts, this rebate alone yielded the Standard over $700,000 annually. This, however, was but a small part of the rebate paid to the Standard Oil Company by these roads. Soon after the pool agreement of October, 1877, the New York Central entered into a contract with the American Transfer Company, a subsidiary of the Standard, to pay it 35 cents a barrel on all oil shipped over its lines whether consigned by the Standard or its competitors. The Erie followed suit, agreeing to rebate the American Transfer Company 20 cents a barrel on all oil fron Bradford, Pennsylvania and 30 cents on all other oil The traffic manager of the Pennsylvania, upon being shown

[22] Record, A/Exhibit 7.

the receipted bills of the rebates from the New York Central and the Erie, agreed to rebate the American Transfer Company 20 cents a barrel on all shipped over its lines. Later this was increased to 22½ cents.[23] In this way the Standard was receiving rebates upon rebates. But by the spring of 1878 certain independents had effected connections so that they could ship oil very cheaply to New York by way of the Erie Canal. Now an opportunity presented itself to the railroads to maintain the business of the Standard "against injury and loss by competition to the end that it may have a remunerative and so a full and regular business." The representatives of the four trunk lines held a conference and made an additional increase to the Standard of 15 cents a barrel. This rebate was effective from May 1, 1878 to December 8, when the competition by canal ceased.[24] But the 10 per cent rebate and the 22½ cent rebate were still in existence in March, 1879.

It is now in order to see whether these rebates resulted in a "remunerative and so a full and regular business" to the Standard. They undoubtedly did so, for from October 17, 1877 to March 31, 1879 they amounted to somewhere between $3,000,000 and $10,000,000.[25] The lower amount even is considerable, for it would pay a return of 5 per cent per annum on a capitalization of

[23] Cassat, Record, 20/17; A/Exhibit 8.

[24] Cassatt, Record, 20/31.

[25] See itemized statement of these rebates by Lewis Emery before Committee on Manufactures, H. R. 1st Session, 50th Congress, 1887-1888.

$60,000,000. But the American Transfer Company made a larger rate of profit than this during the year of 1878. It operated only about 75 miles of pipe line and had a capitalization of $100,000. Nevertheless, upon this small capitalization its rebates from three trunk lines yielded a profit of 3093 per cent. From these figures, it is evident that the protection against loss and injury by competition was remunerative and so produced a full and regular business.[26]

But what was the effect upon competition during these years of the rapid growth of the Standard Oil Company from 1872 to 1879, and especially of the rebates arranged in 1877? In 1872 there were 250 independent oil refineries in the oil country of Pennsylvania alone. By 1878 not over five independents remained in the whole country. In 1888 Mr. Emery produced an exhibit which was a "partial list of the petroleum refineries in Pennsylvania bankrupted, squeezed out, bought up, leased, or dismantled by the great oil monopoly of Ohio and New York, known as the Standard Oil Company." This list named 75 refineries outside of Pittsburg. Twenty per cent of these were "squeezed out" before 1872, thirty "dismantled" between 1875 and 1878, and 17 were "bought up." "In Pittsburg," the exhibit states, "there were 58 refineries in 1877. Thirty refineries have been crushed out and dismantled. No record is left. The remaining 28 have been bought up or leased by the great monopoly.

[26] Rice, 1 R. I. C., 696, reporting F. B. Gavens' argument before the Committee on Manufactures.

. . . Twelve of these are shut down and sixteen only are fitted for business."[27]

Although the freight rates from 1877 and 1879 had a disastrous effect upon competitors of the Standard, yet, in another respect, they brought great benefits to the oil business. In 1878 certain independents decided to free themselves from their dependence on the railroads and to provide a scheme of transportation with which the latter could not possibly compete. For this purpose, they organized the Tidewater Pipe Company and planned a pipe line from the oil regions of western Pennsylvania to the seaboard. By June of 1879 they had completed the line as far east as Williamsport, whence the oil was carried by rail to New York. The Tidewater now demonstrated for the first time the efficacy of pipes for the transportation of oil over long distances. This innovation revolutionized the oil business, for it was to reduce the cost of refining oil by between two and three cents a gallon. It also was to become one of the great bulwarks of the Standard Oil Company. But for the present, a new competitor of promising formidability had arisen; wherefore, there was again an opportunity for the railroads to maintain the business of the Standard "against loss and injury by competition to the end that it have a remunerative and so a full and regular business." They called a conference and made the necessary reduction in rates. They were generous. Crude oil from Titusville, Pittsburgh, etc., was reduced from $1.40 to 50 cents a barrel, and from Bradford to 30 cents. To the Standard the

[27] H. R. First Sess. 49th Cong., p. 232 ff., Vol. 9.

rates were still less, 20 cents from Bradford, and 30 cents from Cleveland, Pittsburgh, etc. On August 1, these were still further reduced, 5 cents upon the Bradford rate and 10 cents upon the Cleveland rate.[28] But these reductions, large as they were, did not put the Tidewater out of business. Consequently other means were used. Some men tried to obstruct the right of way. They bought up farms through which the right of way passed, dated the deed back to a date previous to the securing of the right of way, and then attempted to oust the pipe line. The Standard undersold the Tidewater, bought the refineries in New York which it had contracted to supply, and purchased a minority interest in its stock. By 1883, the Tidewater drew up a compromise with the Standard and divided the business. Since this date the two have been in harmony.[29]

Other independents sought relief from the rebate system by appealing to the courts; and accordingly the state of Pennsylvania was persuaded to bring suit against the Pennsylvania railroad. But these were withdrawn because of a compromise in which the Standard agreed among other things "not to object to an entire abrogation of the system of rebates."[30] But although it did not object to their abrogation, neither did it object to their prorogation. For ex-

[28] *Railroad Investigation*, Welch, p. 3688; Blanchard and Rutter, Exhibits p. 621.

[29] See Warren, Record, 1/191, 192; Benson, 1/208; Lombard, 1/259; A/Exhibit 13.

[30] Record, A/Exhibit 10.

ample, during the years 1879 to 1883 the Lake Shore road carried oil from Cleveland to points west for from 10 to 30 cents less on the barrel than for Scofield, Teagle and Shurmer—a competing firm in Cleveland.[31] The Cleveland and Marietta Railroad, in 1885, entered into an arrangement with the Standard parties by which Rice and others, independent refiners in Marietta, Ohio, were to pay 35 cents a barrel to have their crude hauled from Macksburg to Marietta. The Standard was to pay only 10 cents a barrel for the same services and was to receive in addition 15 cents for every barrel of oil shipped by Rice and other independents.[32] Rice, however, invoked the protection of the courts and secured the refund of this overcharge.

Now by 1887 the effects of railroad rebates and discriminations were becoming generally understood, so that Congress passed the Interstate Commerce Act forbidding such methods and also creating the Interstate Commerce Commission as an agency to remedy them. The Standard Oil Company, anxious to abide by the law, accepted very few rebates after 1887. Instead of going through the cumbersome process of paying an open rate of 60 cents and then accepting a rebate of 20 cents, it simply accepted a special rate of 40 cents straight; or instead of shipping its oil in wooden barrels, it shipped either in iron barrels or in iron tank cars and had these containers entered in a lower class of freight;

[31] Teagle, Committee on Manufactures, H. R. 1st Sess. 49th Cong., p. 544.

[32] Rep. of Master Commissioner Nash to the Circuit Court, Tarbell, Vol. 2, p. 348; *Handy v. Cleveland M. R. Co.*, 31 Fed., 689.

or instead of shipping oil to a distant point through an interstate commerce route, it accomplished this by a combination of a series of local state routes, a plan which was much cheaper and was beyond the jurisdiction of the Interstate Commerce Act; or where the Standard refinery was located in a town in which there was no competing refinery—which was the almost universal rule—the railroads made lower open rates from this point than from competitive points. The result was that the Interstate Commerce Act did not seriously affect the progress of the Standard Oil Company.

There are abundant illustrations of each of these evasions in the United States Report on the Transportation of Petroleum[33]-[34] by the Commissioner of corporations, Mr. Garfield. This report consists of more than 500 pages but it does not aim to give a complete account of all the discrimination enjoyed by the Standard Oil Company. There is, however, sufficient material here for our purposes, i. e., to make clear the effect of railroad rebates and discriminations. According to this report, through secret and open rate discriminations, the Standard received about $1,500,000 in 1904; quite a sum indeed, but a considerable improvement over the year of 1878. I will review a few of the more important ones.

From Olean in southwestern New York, where the Standard has a refinery, the Pennsylvania in 1904 made it secret tank car rates of 10 cents a barrel to Buffalo and 9 cents to Rochester. At the same time the Erie

[33] Referred to as G-

[34] G. p. 21.

had an open rate of 33.6 cents a barrel from Olean to Rochester. Independents around Olean had to pay from 38 to 46 cents to Rochester and 32 cents to Buffalo.[35] The Standard used Rochester and Buffalo as general distributing points for the state of New York, and from them obtained other low secret rates to various points over the state. Thus it reached most of New York at a decided advantage over competitors and consequently acquired the principal part of the trade. These secret rates to Buffalo and Rochester, as compared with the open rates, netted the Standard a direct gain of $121,776 in 1904.[36]

The Standard also enjoyed unusually low rates from Olean to points in Vermont. This is accomplished by combining a series of rates. For example, to the secret rate of 2.8 cents per hundred pounds from Olean to Rochester it added a secret local rate of 9 cents granted by the New York Central from Rochester to Norwood in northern New York, and to these two it added a special tank car rate of 3.54 cents from Norwood to Burlington, Vermont. In this manner it reached Burlington at a rate of 16.12. But independents from Warren, Pa., near Olean had to pay 33 cents per hundred pounds to Burlington and 23 to Rutland.[37] From Burlington the Standard received other special local rates to various towns in the state. These were more than 9 cents per hundred pounds less than to competitors if the shipments were made in less than car-

[35] G. p. 95-100.

[36] G. p. 97-100.

[37] G. p. 112.

loads, and over 11 cents per hundred pounds less if they were made in car-loads. By these combinations of local rates, the Standard reached the distributing centers of Vermont for a rate that was from 17 to 18 cents less per hundred than its competitors, and the final destination beyond for from 16 to 29 cents less.[38] The result was that little independent oil reached Vermont.

If we now turn our attention to Whiting, Indiana, a suburb of Chicago, where the Standard has one of its largest refineries, and compare the oil rates from this town with those from Toledo where the nearest competitor is located, we find a set of rates analogous to those from Olean. From the refinery in Whiting the Standard supplies the principal part of the Mississippi Valley, and, previous to 1904, also supplied most of the states of the Southwest. For our purpose it is sufficient to examine the rates to the South-Central and the Southwest Territories from Whiting and Toledo.

The South-Central territory comprises the states south of the Ohio and east of the Mississippi. All this except a part of Kentucky, and a strip along the Atlantic coast, the Standard supplied from Whiting. It was reached principally by two secret rate combinations known as the Grand Junction and the Evansville combinations. Both of these existed about ten years before they became public. The Grand Junction combination led from Whiting to Grand Junction, which is a small railway crossing in the southwestern corner of Tennessee and at the extreme western corner of the

[38] G. p. 127, 128.

South-Central territory. From this point the oil was carried east and south by the Southern Railway. The Evansville combination led from Whiting to Evansville, Indiana, where connections were made with the southern roads, chiefly the Louisville and Nashville. The route by Grand Junction was a very circuitous one but it meant an advantage over direct open rates of from 3½ to 29½ cents a hundred, according to the final destination, and it saved the Standard about $72,000 a year.[39] The Grand Junction rates to the points in the south were an average of 12.79 cents per hundred pounds less than competitors' rates to the same points from Toledo. The average distance to ten representative towns reached by the Grand Junction rates, such as Birmingham, Alabama, or Chattanooga, Tennessee, or Spartenburg, South Carolina, is 690 miles from Whiting by the most direct route, but by the circuitous route by way of Grand Junction increased the distance to 993 miles.[40] Now the same towns had an average distance from Toledo of only 664 miles. Thus a slight advantage in distance for Toledo meant a great disadvantage in rates.

The Evansville Combination netted an advantage of about 7.86 cents per hundred over the competitors' rates from Toledo and saved the Standard $10,963.72 per year.[41] The distance to ten representative towns reached by this combination, such as Nashville, Tennessee; Bowling Green, Kentucky; Charlotte, North

[39] G. p. 253.

[40] Calculated from table, G. p. 255.

[41] From table G. p. 284, 287.

Carolina; and Grenada, Mississippi, was 609 miles from Whiting. From Toledo it was 33 miles farther. Here a slight disadvantage in distance for Toledo meant a great disadvantage in rates.

To points along the Gulf and the lower Mississippi, the railroads from Chicago made low open rates in connection with the southern roads in order to meet water competition. The rates were 9.5 per hundred less from Chicago and Whiting than from Toledo, largely because the railroads from Toledo did not make through connections to these points.[42]

If now we make a comparison of the rates from Whiting and Toledo to all the 64 principal towns in the South-Central territory reached by the Evansville and the Grand Junction Combinations, and the low rates from Chicago, we get the following set of facts: The average rate from Whiting to these towns, i.e., 38.7 cents per hundred pounds and 49.1 cents from Toledo—10.4 cents in favor of Whiting. The average ton-mile rate from Whiting is 1.08 cents, and 1.31 cents from Toledo—.24 cents in favor of Whiting. The average distance from Whiting is 751 miles and from Toledo 742 miles—9 miles in favor of Toledo. If we take 43 towns reached by way of Grand Junction, the average distance of the actual route to them from Whiting is 1087 miles as against 712 miles from Toledo.[43] From this we see that, although Toledo is on the average nearer to points in the South-Central Territory than Whiting, yet the latter town has an advantage in rates

[42] See table, G., p. 290.

[43] From table G., p. 296 ff.

of 10.4 cents per hundred pounds. This advantage, Mr. Garfield says, "is equal to about five-eights of a cent a gallon. Independent refiners can live on a profit of one-fourth a cent a gallon on refined oil and consider one-half cent liberal return on their investment in refining plants. The Standard Oil Company could make a large profit in the south at prices that would leave absolutely no profit to independents. It is not remarkable therefore that the Standard Oil Company has a complete monopoly of the sale of refined oil and naptha in the southern states. . . . The prices . . . are exceedingly high. . . . In large areas they are 2 to 4 cents a gallon higher than in certain points where competition is active, after taking into account the freight rates."[44]

The Southwest Territory, comprising the states of Arkansas, Texas, Oklahoma, Indian Territory, Arizona, and the southern half of Missouri, presents an exactly similar situation to the one just described. The Standard reached this territory by various combinations of rates—secret, local, and otherwise—so that on an average its rates to the Southwest were over 12 cents per hundred pounds lower than from Toledo; whereas, compared with other rates of the same class as oil, the difference should have been only 5 cents on account of the greater distance for Toledo. The difference in favor of Whiting produced the same result as in Vermont or in the South, namely monopoly for the Standard Oil Company.

[44] G., p. 302.

It is not necessary to review further the rebates and discriminations given by the railroads to the Standard Oil Company. It would be merely continuing and repeating the same story, describing how in each case they inevitably forced out the competitors and brought about a monopoly for the Standard. I must now show the reason for this connection between railroad discrimination and monopoly—that is, I must inquire whether or not the rebates received by the Standard Oil Company were sufficient to cover the margin of profits required by independents.

The inquiry is solved by finding out what investment is required in the oil business to yield a reasonable profit. The Report on the Petroleum Industry[45] by the United States Bureau of Corporations gives authoritative statements on this point. The average investment in the refining business for five Standard refineries is $1.05 per barrel of crude. The average investment in the marketing business for the same refineries is $1.24 per barrel of crude oil, making a total of $2.29.[46] The average investment for the five independent refineries is $1.23 per barrel[47] of crude. The amount invested by independents in the marketing business is not known, but their marketing costs are no higher than the Standard's[48] and so we may suppose the investment is no greater. This would bring the total investment for the independ-

[45] Hereafter referred to as S.

[46] S. 2, p. 605.

[47] S. 2, p. 598, 600.

[48] *Ibid.*, 660.

ents to \$2.47 per barrel of crude. Assuming 8 per cent to be a living profit, then the Standard would require a profit of 18.32 cents a barrel of crude and the independents 19.76 cents. Now the market value of the refined oil derived from a barrel of crude varies from 50 to 70 per cent of the total products.[49] Assuming the average to be 60, then 60 per cent of the profits must come from the refined. This would be 11 cents for the Standard and 11.85 cents for the independents. The quantity of refined derived from a barrel of crude varies from 14.5 to 24 gallons. Supposing 19 gallons to be the average, then the Standard must realize a profit of .58 cents and the independents .62 on every gallon of refined sold. But a reduction of 10 cents per hundred pounds of freight is equal to .64 cents per gallon. Therefore, if the Standard has this much advantage in freight rates, it can sell oil at a profit for prices that would leave less than nothing to the independents. It makes no difference then whether or not it has other advantages in the cost of production. The discrimination is sufficient to kill competition. From these results it can be clearly seen that rebates and discriminations mean a surplus in the Standard's treasury but bankruptcy to the competitor.

Our summary review of railroad discrimination in connection with the Standard Oil Company thus shows how they made possible one of our great industrial monopolies. Of course, the Standard aided its progress by a few other factors such as local price cutting

[49] S. 2, p. 668 ff.

and a peculiar system of espionage; but these have been factors which assisted it in maintaining its monopoly rather than causal factors in building it up. Because of these advantages, it is not surprising that between 1872 and 1906 the Standard Oil Company acquired the interests of at least 200 competitors engaged in refining marketing, and piping oil;[50] destroyed without acquiring 245[51] competitor's between 1872 and 1879, and an unknown number since that period; increased its assets between 1882 and 1906 from $55,000,000 and $359,000,000; earned during the same time $838,000,000 in profits; and realized 25 per cent annually on its investment and 48 per cent in dividends on its capital stock.[52] Now, doubtless, good business methods and technological excellence contributed to this wonderful success. But considering the importance of rebates, it seems clear that the railroads accomplished their purpose in maintaining the Standard "against injury and loss by competition to the end that it may have a remunerative and so a full and regular business."

SECTION II. *Judicial Opinion upon Rate Discrimination.*

From our review of rebates and discrimination in connection with the Standard Oil Company, we can see how a slight discrimination in railroad rates determines absolutely who the shipper shall be and who

[50] Record, Petitioners' Brief, Vol. I, p. 92 ff.

[51] Emery, Committee on Manufactures, H. R., 1st Sess. 49th Cong., Vol. 9, p. 232. Exhibit A.

[52] *Ibid.*, p. 170.

shall conduct business in the territory to which the discrimination is made. The railroads, for this reason, hold in their hands the scales of competition and upon them depends the answer to the question whether monopolies shall exist or fall. Therefore, the adjustment of railroad rates is a matter of no small importance, and to make them just and fair to all parties concerned presents the keenest problem.

Another important feature to notice in this story of rebates is that the Standard Oil Company and the railroads bargained together and made special deals in the same way that is common between private individuals. The reasons for rebates were purely private and commercial. For the railroads the Standard's business was an important item. Rather than do without it, they would make a special bargain, because even a small profit was better than none. It would contribute something towards general expenses and might also help in the matter of dividends. On the other hand, the Standard was anxious to make the best bargains possible. A reduction in rates would mean not only that much more profit but the greater advantage in driving out competitors, who always disturbed the market. However, from the standpoint of public policy, it is a very serious question whether this sort of special bargaining between monopolistic corporations is permissible, even for business reasons which may appear legitimate in a sense. And even if it is permissible between large industrial corporations, it is still further a question whether it is proper in any way for common carriers to engage in such special bargaining. The question is:

Can a large corporation behave in the same way as an ordinary shopkeeper, who may sell a suit of clothes to one man at a certain price and another suit of the same cost to another man at a different price?

The present chapter will deal with this question in its relation to common carriers which, it is agreed, are affected with a public interest; and, in the following chapter, we will consider the same question with reference to large industrial corporations. In examining English and American court decisions on rebates we find judicial authority on both sides of the question, and we shall find it profitable to examine the arguments both for and against rate discriminations.

One of the grounds on which courts have favored rebates and discrimination is an argument based on common law.[53] It may be put as follows: Under the common law, common carriers are not obliged to treat all patrons alike. A carrier is obliged only to charge a patron a price for services which is reasonable in itself, and what others are charged is none of his concern. As Judge Crompton said: "Charging another person too much is not charging you too little." A carrier may even haul goods free of charge to one person, but this does not in the least obligate him to haul goods free of charge to all persons. And, if a carrier, in certain isolated cases, makes a contract to haul goods for one person at a rate that is below the usual, regular,

[53] *Garton and another v. Bristol and Exeter Ry. Co.*, 1 Q. B. (B. S.) 112 (1896); *Fitchburg Ry. Co. v. Gage et al* (1859), Gray 393, 394, 399; *H. and T. C. Ry. Co. v. Rust and Dinkins* (1882) 58 Texas, 98. 110.

and reasonable rate, he may undoubtedly do so without entitling others to the same advantages. It will be seen that this argument applies the law of private shop-keepers to common carriers, and does not consider it as changed by the fact that the latter are affected with a public interest. The argument always forms a part of "counsel's brief for defendant," and is strongly urged as being "the law" applicable to the case at bar. But we shall see farther on that the common law was essentially changed by statutes which recognized a difference between private shop-keepers and common carriers affected with a public interest. Besides this argument from common law, courts have recognized a second argument as validating the practice of rebating. This argument applies the principles of the wholesale trade to rate charges.

A carrier may make a contract giving a lower rate to a shipper who furnishes the railroad a large quantity of traffic, given in specified amounts, at regular intervals, and for a long period of time, when such a contract increases the legitimate profits of the railway and the discrimination is no more than a reasonable consideration for the diminished cost of service. In fact, such advantages are similar to differences made between the selling of goods wholesale and retail. Besides, it is a matter of common knowledge, and hence one of which judicial notice is taken, that an increase in the volume of business is desirable and advantageous; and, in the rivalry of business competition, it is lawful to favor those whose business is great, rather than those whose business is small or inconsiderable. More than this, the lower rate in favor of large traffic is more profitable to the railroad than higher rates on small traffic which is intermittent and irregular, because it results in greater economy in arrangement of trains and in the organization of the service. The railway's plant and equipment can also be in more constant use, a condition which is desirable because there is very little more expense in having them constantly in use and so earning something than in having them idle. For exectly similar reasons the shipper can also conduct his plant with greater economy, and it is desirable for the public good that goods for consumption be produced as cheaply as possible. A discrimination in favor of large traffic, therefore, is desirable both for the railroad and the shipper because it increases the profits of each; and it is desirable to the public because it cheapens the cost of production, making possible a lower price to the consumer.[54]

Such, in a modified form, is the line of argument in the Nicholson case, where the English judges affirmed the validity of a ten-year contract between a coal company and a railroad, the latter agreeing to make lower rates to the coal company in consideration of its furnishing train-loads of coal, at stipulated intervals, and in such quantities that the railroad would receive

[54] *Nicholson v. G. W. Ry. Co.* (1858), 5 C. B. (N. S.) 336; *Garton v. B. and E. Ry. Co.* (1859) 6 C. B. (N. S.), 639, 655; *C. C. C. and Ind. Ry. Co. v. Cosser et al.* (1890), 126 Ind. 348; *Root v. Long Island R. R. Co.* (1894), 114 N. Y., 300; *Western Union Tel. Co. v. Pub. Co.* (1900), 181 U. S. 92; *Savitz v. Ohio and Mississippi R. R. Co.*, 150 Ill. 208.

40,000 pounds sterling annually in gross earnings from the traffic. The case has been cited with approval by American courts in several instances, and, like the argument from common law, always forms a part of the argument for defendants in an action against rebating. The case is especially important in view of our illustration from the Standard Oil Company, because almost the same reasoning is given by Gen. Devereaux in an affidavit in which he explains why he, as vice-president of the Lake Shore Railroad, reduced the rate from Cleveland to New York from $2.00 a barrel to $1.30, for the firm of Rockefeller, Flagler, and Andrews, the fore-runner of the Standard. He found that it ordinarily required 30 days for a feight car to make the round trip from Cleveland to New York. But on being guaranteed a solid train of 60 car-loads of oil per day the time for the trip could be reduced to 10 days. Consequently, not so many cars would be required and the investment for the company on this business would be reduced from $900,000 to $300,000. Because of these facts he gave them the lower rate; since, as he says, "charges for transportation being necessarily based upon actual cost of service . . . to refuse to give them the benefit of such reduction would be to the detriment of the public, the consumers, who in the end pay the transportation charges."[55]

The argument then is essentially that a rebate in favor of large traffic is justifiable because of a diminished cost of service. Now I do not deny that to base

[55] Tarbell, *Hist. of the Standard Oil Co.*, Vol. 1, Appendix, p. 277-79.

the rates upon cost of service is a sound policy; but to charge one large shipper a rate which allows a reasonable profit upon cost of service while competitors are charged as much as the traffic will bear is inconsistent. Besides, there may be cases in which the cost of service is not a sound principle, especially if it tends to foster a monopoly. Of this more hereafter.

The fallacy of the common law, which provided that common carriers must make their charges reasonable but not necessarily equal to all, was soon noticed when railroads began to play an important part in the commercial life of England. It was observed that a railroad necessarily had a monopoly of the traffic along much of its line, and that, by making unequal charges to different shippers, it could destroy competition among them and give one shipper a monopoly of a given business. On this account, statutes were passed requiring carriers to charge equal rates on goods of the same description and under the same circumstances. This situation is well explained in an opinion handed down in 1869 by the House of Lords through Mr. Justice Blackburn.

According to this opinion, if a party sought to show that under the common law he was charged extortionately by a railway, it was not enough to show that others were charged less for the same services; for the common law allowed this and even permitted a carrier to haul goods gratis for a favored individual. Such evidence only *tended* to show his charge to be unreasonable. But in the Railways Clauses Consolidation Act of 1845 the Legislature was of the opinion that "the changed state of things arising from the general use of the railways" made it expedient to impose an obligation on them beyond what is required at common law, namely, they might charge what they thought fit, but one person not more than another, during the same time and in the same circumstances. And when it was sought to prove charges extortionate, there was this proviso: "It is immaterial whether the charge is reasonable or not, it is enough to show that the company carried for some other person or class of persons at a lower charge during the period throughout which the party complaining was charged more under like circumstances."[56]

This decision, then, over-ruled the earlier ones which permitted rate discrimination by railroads, and clearly recognized that the principles and practices allowed to small shop-keepers could not be allowed to the railroads which, as common carriers, are obliged to charge all alike under the same circumstances, for the same services, during the same time; and if one person was charged more than another, that was ipso facto proof that the higher rate was extortionate.

It was not long until some of the judges in America also perceived the injustice of permitting the railroads to make discriminations in their rates and recognized the distinction between private and public business. Along this line is the noted opinion handed down by the Supreme Court of New Jersey in 1873, in the case of Messenger v. Pennsylvania R. R. Co. The plaintiffs

[56] *Great Western Ry. Co. v. Sutton*, 4 L. R. Eng. and Irish App., 226, 239.

had made an agreement with the railroad that they should be given a rebate of 20 cents per hundred pounds from Chicago and 10 cents from Pittsburgh on live hogs shipped by them to Jersey City. Further, if other parties, except seven named, should receive a drawback for the same services, plaintiff's rate should be 20 and 10 cents below such rates according as they were from Chicago or Pittsburgh. This second condition was not complied with, wherefore plaintiff sued to recover rebates as per contract. It will be noticed that this agreement is substantially the same as the rebating contract made by the South Improvement Company with the same railroad, and is, therefore, deserving of attention. The Court said:

"A merchant who can transport his wares to market at less cost than his rivals, will soon acquire, by underselling them, a practical monopoly of the business. . . . The tendency of such compacts is adverse to the public welfare, which is materially dependent on commercial competition and the absence of monopolies. . . . "The defendants are common carriers and it is contended that bailees of that character cannot give preference in the exercise of their calling. . . . Such partiality is legitimate in private business, but how can it square with the obligation of a public employment? . . . to permit the common carrier to charge various prices according to the person with whom he deals, for the same services, is to forget that he owes a duty to the community. . . . A company of this kind is invested with important prerogative franchises, among which are the rights to build and use a railway, and to charge and take tolls and fares. . . . If they had remained under the control of the state, it could not be pretended, that in the exercise of them, it would have been legitimate to favor one citizen at the expense of another. . . . In their very nature and constitution, as I view this question, the companies become, in certain aspects, public agents, and the consequence is they must, in the exercise of their callings, observe to all men a perfect impartiality."[57]

In this case, it does not appear that the rebate was granted because of an unusually large traffic. But the danger of such discrimination was clearly perceived by the federal court in Ohio, in Hays v. Pennsylvania Co., which for America over-ruled the Nicholson case in England. Plaintiff was discriminated against in rates for carrying coal. Defendant had a scheme providing a rebate varying from 30 to 70 cents per ton to companies or persons shipping 5,000 tons or more per year, the amount of rebate varying with the quantity shipped. The court said: "The discrimination complained of rested solely on the amount of freight supplied by the "respective shippers during the year. Ought a discrimination resting exclusively on such a basis be sustained? If so, then the business of the country is, in some degree, subject to the will of the railroad officials; for, if one man engaged in mining coal, and dependent on the same railroad for transportation to the same market, can obtain transportation thereof at from 25 to 50 cents per ton less than another competing with him in business, solely on the ground that he is able to

[57] 36 N. J., 407, 409, 410, 412, 413, 414.

furnish and does furnish the larger quantity for shipment, the smaller operator will sooner or later be forced to abandon the unequal contest and surrender to his more opulent rival. If the principle is sound in its application to rival parties engaged in mining coal, it is equally applicable to . . . everybody else interested in any business requiring any considerable amount of transportation by rail; and it follows that the success of all such enterprises would depend as much on the favor of railroad officials as upon the energies and capacities of the parties prosecuting the same.

"It is not difficult, with such a ruling, to forecast the consequences. The men who control railroads would be quick to appreciate the power with which such a holding would invest them, and, it may be, not slow to favor their friends to the detriment of their personal or political opponents, or demand a division of the profits realized from such collateral pursuits as could be favored or depressed by discrimination for or against them; or else, seeing the augmented power of capital, organize into overshadowing combinations and extinguish all petty competition, monopolize business, and dictate the price of coal and every other commodity to the consumers. . . . Capital needs no such extraneous aids. It possesses inherent advantages which cannot be taken from it. But it has no just claim, because of its accumulated strength, to demand the use of the public highways of the country constructed for the common benefit of all, on more favorable terms than are accorded to the humblest in the land; and a discrimination in favor of parties furnishing the largest quantity of freight, and solely on that ground, is a discrimination in favor of capital, and is contrary to a sound public policy, violative of that equality of right guaranteed to every citizen, and a wrong to the disfavored party, for which the courts are competent to give redress."[58]

I have quoted the above opinions at some length, because they are representative of the prevailing rulings in the United States against railroad discriminations. A discrimination in rates is unlawful because of public policy. The railroad company is created by the state to perform one of its functions, and, as performing such a function in the capacity of a public agent, is obliged to treat all men with perfect impartiality, because this is required to promote the good of the state. The common good of the state is also materially dependent upon the prevalence of competition and the absence of monopoly. Therefore, a railroad cannot make discriminations in its charges, because this destroys competition and establishes monopoly which can by its own power, and at its will, fix the prices of commodities to consumers.

What is interesting in these decisions for and against rate discrimination is the development of the conception that railroads come under the rule of public law. The early discussions in favor of discrimination apply the old rules of private business and do not take cognizance of new conditions caused by the introduction

[58] 12 Fed. 309, 313, 314; cf. also *Louisville etc., R. R. Co. v. Wilson*, 132 Ind. 517. *Griffin v. Goldsboro Water Co.*, 122 N. C., 206; *Fitzgerald and Co. v. Grand Trunk R. R.*

of the railroad into the field of commerce. Psychologically, the old habits persist in the new situation without an awareness of their inadequate functioning. Legally, it is a firm adherence to the precedents governing the case without a critical study of the facts. Such a procedure is quite natural until the inadequacy of the rules of private business as applied to a public carrier has been made distinct by a study of results, namely, that the application of private law to a public carrier results in a destruction of healthy competition between shippers, and in the reëstablishment of a monopoly for the favored shipper, the evil of which was made clear in *Hays v. Pennsylvania Co.* After this result was forseen, the application of private law was abandoned and the conception developed that a railroad's business is public in character and should therefore discharge its duties impartially like the state itself. This procedure is justified because it is in the interest of the public. The judges developing this conception are not closely governed by precedent but make a close study of the facts of the situation to which their ruling is to apply. Precedent failing them, they appeal to what they consider the ultimate ground of law and the purpose for which law exists, namely, the promotion of the common good or welfare or the public interest. It is the judge who is constructing law that holds this situation before him, and, in point of time, he usually comes toward the close of a transition period, a stage of conflict between old rules and new conditions. On the other hand, the judge who comes at the beginning of such a period of transition or conflict or who is in circumstances where rules and situations happen to fit, pays no attention to any such criterion but merely studies precedent and gives his decision accordingly. Psychologically, this is similar to the change from old to new habits in an individual, the difference being that laws are social habits instead of personal ones. It cannot be doubted that these psychological and methodological differences between the judges giving these opposite opinions are fundamental in the explanations of their rulings, a point which will become more clear in our study of court decisions on the competition between manufacturers or producers.

SECTION III. *How the Courts Developed a New Principle for Testing the Fairness of Railroad Rates.*

Having once established the view that railroads are public service corporations, and, as such, are under obligation to charge all shippers impartially, the courts put upon themselves the necessity of constructing a principle by which fair and impartial rates may be determined. The growing character of law together with the conflicts and differences incident to such growth is clearly illustrated in the line of decisions aiming to establish what constitutes a fair basis of rate charges. These we shall accordingly review.

In *Smith v. Ames* the Supreme Court said: "What the company is entitled to is a fair return upon the value of the property which it employs for the public convenience." With this proposition there has been very general agreement from all sides. But there has been very general disagreement as to what constitutes "fair return" and "value."

With reference to value there have been in the main two theories, the one that value is determined by cost and the other that it is determined by earning capacity. The cost theory has taken two general forms: the first that value is determined by what it cost originally to make the article or plant; the second that value is determined by what it costs to reproduce the article or plant in its present condition, allowing both for depreciation and appreciation. The emphasis has been decidedly upon this second form, and as such, is used by a number of public service commissions for determining the reasonableness of rate charges. There is, however, some judicial authority in favor of the earning capacity theory, and it will be best to review this first.

In *Chicago, Milwaukee, & St. Paul v. Minnesota*[59] the Supreme Court said: "If the company is deprived of the power of charging reasonable rates for the use of its property, it is deprived of the lawful use of its property, and thus in substance of the property itself," recognizing that a property must have some earning capacity in order to have any value at all. This principle was reaffirmed in *Cleveland and Railway Co. v. Backus*,[60] which was a taxation case. In this the Court said that the value of a property results from its use and that outside of its use it has no pecuniary value. "Take for an illustration," explained the Court, "property whose sole use is for purposes of interstate commerce, such as a bridge across the Ohio, between

[59] 134 U. S. 458.

[60] 154 U. S. 445, 446.

the states of Ohio and Kentucky. From that springs its entire value. . . . Suppose that there be two bridges across the Ohio, one between Cincinnati and Newport, and another twenty miles below where there is nothing but a small village on either shore. The value of the one will manifestly be greater than that of the other." In *San Diego Land and Town Co. v. Jasper*[61] it was said that original cost does not determine value. On the contrary, a plant has an actual value," which the Court said, "depends upon a variety of considerations, among them, the actual and prospective number of customers."

Although the phrase, earning capacity, does not occur in these quotations, yet it is clearly implied; for "use," "rates," "number of customers," etc., are the determinants of earnings, and upon these, it is said value depends. No one would deny that earnings are a factor in determining value, at least market or sale value. If a corporation could not earn anything, it would be worth nothing at all. Our present problem, however, is not how earnings determine value, but *how much* a company may fairly earn and *by what tests* we can tell whether or not a given earning is fair. If we intend to fix a capitalization upon which to base and calculate a fair earning, it is clear that we cannot use earning as the basis of our capitalization, for this would be moving in a circle. This difficulty was noticed by Judge Thayer in *Collings v. Kansas City Stockyards Co.*[62] He said that income cannot be accepted as the test of the

[61] 110 Fed. 714.
[62] 82 Fed. 854.

value of a property affected with a public use because the owner may have made excessive charges for its use. Nor can the amount of capitalization be made a test "because the stock may not represent money actually invested, and, furthermore, because the property may have been capitalized with reference to its income producing capacity."

It is because of the reasons mentioned by Judge Thayer that most of the cases upon valuation have centered about the cost theory. But even in determining value apart from earnings there are many elements to be considered. For example, in *Smith v. Ames*, the Supreme Court said: . . . "the basis of all calculations as to the reasonableness of rates must be the fair value of the property used for the convenience of the public. And in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stocks, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statue, and the sum required to meet operating expenses are all matters for consideration."[63]

The items mentioned here all undoubtedly enter into market value, but upon reflection, it at once becomes clear that they cannot all enter into the "fair value" which is to be a basis for rate charges, for they include both cost items and income items. Income depends upon rate charges, and where the fairness of income and rates is in question, it is again moving in a circle to

[63] 169 U. S. 547.

capitalize the income and then calculate the income and base the rates upon this capitalization.

Later decisions of the Supreme Court have made the "fair value" that is to be the basis of rate charges more specific. In *San Diego Land and Town Co. v. National City*,[64] the Court said that the value of the property, meaning principally the tangible assets, was to be taken "at the time it is being used for the public," and this as against the original cost or amount of bonds both of which may have been excessive. This opinion was reaffirmed by Justice Holmes in *San Diego Land and Town Co. v. Jasper* and again by Justice Peckham in *Stanislaus v. San Joaquin C. & I. Co.*[65] But the clearest opinion along this line was by Judge Hough in the Consolidated Gas case. He said, "In every instance, however, the value assigned in the report is what it would cost to reproduce each item of property, in its present condition, and capable of giving service, neither better or worse than it now does. . . .

"Upon authority, I consider this method of valuation correct." Then referring to the cases cited above he continues: "It is impossible to observe this continued use of the present tense in these decisions of the highest court without feeling that the actual or reproductive value at the time of the inquiry is the first and most important figure to be ascertained. . . . Upon reason it seems clear that in solving this equation, the plus and minus quantities should be equally considered, and appreciation and depreciation treated alike."[66]

[64] 174 U. S. 757.

[65] 189 U. S. 442.

[66] 157 Fed. 855.

When this case was appealed to the Supreme Court under the title of *Wilcox v. Consolidated Gas Co.*,[67] Justice Peckham, who delivered the opinion, concurred with the lower court upon the method of valuation and said further: "If the property which enters legally into the consideration of the question of rates has increased in value, since it was acquired, the company is entitled to the benefit of such increase. This at any rate is the general rule."

Cost of reproduction in present condition, allowing both for appreciation and depreciation, is thus, according to the courts, the proper basis for determining the reasonableness of rates, in case of a public service corporation. It is not original cost, for the plant may not have been economically constructed; nor income, for this may be the product of unreasonable rate charges; nor is it capitalization, for this may not represent money actually invested or it may be used on unreasonable rate charges.

Valuation, as thus determined, has reference chiefly to the physical properties used for the public convenience, such as real estate, plant, equipment, working capital, etc., the so-called tangible assets. This valuation, while correct in most items, yet appears open to question upon the unearned increment in land. There are several reasons why the allowance of this to a public service corporation is inadvisable. It is well known that land in a growing city or country increases in value whether or not the owner makes improvements upon it. It cannot be denied that hope of enjoying this

[67] 212 U. S. 52.

increase has, in many cases, been a stimulus to owners for making improvements and it also has been an inducement to pioneers in settling and building up a new country. In such cases, however, the "unearned increment" can hardly be said to be unearned. But whatever may be the justness of allowing the unearned increment in land to private individuals, the case is different with public service corporations; for here the incentive to business is profit from volume of traffic. Besides, a public service corporation is chartered by the state to perform a particular function, and because of this, it has the right of eminent domain to locate its properties where it chooses. It can, therefore, select those places where land is apt to rise most rapidly in value. If it fails to select them upon its first right-of-way, it can do so later. A private individual, however once having purchased land cannot move his property to a more favorable location nor can he dispossess the owners whose land is apt to increase most rapidly in value. This is possible, however, to a public service corporation, and its primary object in doing so may be to enjoy the unearned increment. If so, the unearned increment is an incentive to an abuse of privilege rather than for making improvements. For this reason its enjoyment is properly denied to a public service company. The company can, of course, argue that it is a producer of the increase in land value, but to this it is sufficient to reply that whatever it contributes to the material development of a community, it fully regains in the subsequent increase in the volume of traffic or business. No one would deny that if a corporation pays for real estate, it should be allowed to make this cost a part of its capitalization; but this is no reason to allow it to enjoy the unearned increment.

In addition to admitting into the capitalization the tangible assets, the courts, in some cases, have recognized many so-called intangible assets, such as favorable location, good will, good management, going value, and franchise. But none of these have been admitted by the Supreme Court as permanently allowable elements in the valuation that is to be the basis for determining rates; and with reason, for the value of these elements depends upon the earning capacity of the plant. If, therefore, any allowance should be made for them, it can be done more equitably in the rate of profit than in the valuation upon which profits are calculated. In this way we avoid the circle of capitalizing profits or earnings and then testing the fairness of earnings by this capitalization.

Location,[68] for example, has value only in so far as it affects earnings. A railroad which has accessible terminals in the chief centers of distribution, many connections, and many enterprises along its lines will have far greater earnings than one that is connected principally with small and thriftless towns, although the cost of reproduction of either one would be the same. Such a circumstance, if it is the result of choice and good management, may possibly be an allowable excuse for larger profits. But to capitalize these profits and then argue that the rate of profit is no more than the ordinary rate of interest upon the capitalization is to test the

[68] 90 Fed. 687; 91 C. C. Rep. 402; 113 Pac. 681.

fairness of earnings by themselves. If the capitalization is to be a criterion of fair earnings, it is clear that such a feat is impossible.

The same reasoning applies to good will,[69] which has been defined by Lord Eldon as "nothing more than the probability that old customers will resort to the old place." This implies choice as to whom the consumer shall give his custom and can therefore exist only in a competitive business. In a monopoly, however, the old customer must resort to the old place or else do without the monopolist's goods. For this reason the Supreme Court in *the Consolidated Gas*[70] case admitted that a monopoly cannot have any good will and can neither capitalize it nor make it an excuse for increased profits.

Allowance for favorable location was admitted in *Metropolitan Trust Co. v. Houston*, etc.,[71] as part of the capitalization upon which the railroad is entitled to earn a return. The judge argued that because the road in question ran through the most populous and growing part of the state and was put there by judicious selection, it had established a business which could not be disregarded in estimating the value of the road either as a business property and venture of the road either as a business property and venture or as a property having a quasi-public nature. In

[69] Lord Eldon, *Words and Phrases*.

[70] Consolidated Gas case, 157 Fed. 872; idem, 212 U. S. 52; see also *Cedar Gas Light Co. v. City of Cedar Rapids*, 120 N. W. Rep. 969; supra, 90 Fed. 687.

[71] 90 Fed. 687-8.

re-proposed advances in freight rates,[72] the Interstate Commerce Commission said that the value of a railway system is principally a matter of location, terminal facilities, connections, and enterprises long the line, and that allowance should be made for the ability and foresight that worked out and perfected the system. The element of location, if it is a matter of judicious relation and foresight, may be a reasonable ground for increased profits, but to capitalize these profits and then argue that the rate of profit is fair because it is no higher than the ordinary rate of interest upon the capitalization, is again testing the fairness of earnings by themselves.

This reasoning applies in the same way to good management.[73] The success or failure of a business often turns upon good management. As before intimated, the location of a railway with reference to terminals, connections, and enterprises may be the result of this art. On the other hand, if a railway is efficiently managed, running its trains regularly and delivering all its goods promptly, enterprises may choose to locate along its lines on this account and so increase its business. This is none the less true of a monopoly than of a competitive business. Again, a good manager often impresses his art upon the property and business so that it continues to live long after him, and as a consequence, the business is always prosperous. If, on the contrary, a railroad has poor managers during its early history, it may be generations before it can overcome

[72] 9 I. C. C. 402.

[73] See 113 Pac. 681; 59 At. 540.

the bad effects of the same. Because of the importance of good management it is both in the interest of the railway and the community to have talent along this line developed as much as possible, and some reward ought to be offered to stimulate it. If, however, we allow good management to be capitalized, not only would all the stockholders share in it alike whether or not they contribute anything to the management but we should also fall into the vicious circle descr bed above, i. e., we should be capitalizing earnings. But if the fairness of the earning is in question, we cannot capitalize earnings at the ordinary rate of interest, and then turn around and argue that earnings are fair, because they will yield an ordinary rate of interest upon the capitalization. Like location, good management is therefore best provided for either in the rate of profit or in the way of an increased salary.

Good will having been excluded from the capitalization of a monopoly, many corporations have tried to find a substitute in "going value" by which[74] is understood that value a plant possesses in virtue of its being a live one, operating and earning, instead of a dead one only capable of earning. It has been admitted by some courts as a proper element in determining market or sale value but the Supreme Court has not allowed it to be made a part of the capitalization for determining rates. For example, in *National Water-works Co. v. Kansas City*, which was a case to determine the sale value of a water plant, Justice Brewer said: "The fact that it (the water plant) is a system in operation, not

[74] 120 N. W. Rep. 969; 113 Pac. 681.

only with a capacity to supply the city, but actually supplying many buildings in the city—not only with a capacity to earn but actually earning—makes it true that "the fair and equitable value" is something in excess of the cost of reproduction.[75] This opinion was affirmed by the Supreme Court in *Omaha v. Omaha Water Co.*,[76] which was also a case for determining the sale value of a water plant. But the court took care to add: "No such question was considered in *Knoxville v. Knoxville Water Co.*, 212U. S. 1, or in *Wilcox v. Consolidated Gas Co.*, 212U. S. 19. Both cases were rate cases and did not concern the ascertainment of value under contracts of sale," thus carefully distinguishing between "going value" as an allowable element of market value and as an unallowable element of a capitalization that is to be the basis for rate charges. If the court would not make this distinction, we should again be allowing an opening for "watered stock," permit the capitalization of earnings, and so defeat our criterion for determining a fair earning. But "going value" as an element of market or sale value seems fair, for the earnings of a plant already in operation are more certain than the earnings of one that has not been tried. A buyer would be willing to allow something for this greater security. To put a new plant into operation would require time, some changes and repairs would probably have to be made, the construction might be faulty and require adjustment, etc.—these elements,

[75] 62 Fed. 865; also affirmed in 17 Mass. 865, and in 76 Conn. 565.

[76] 218 U. S. 203.

for the first year at any rate, would lessen gross earnings and increase operating expenses so that the market value, which is largely dependent upon earnings, would be appreciably less than of a plant having an equal reproductive cost but already earning and operating. For this reason, "going value" is allowable in a case of sale; but to make both it and the small earnings of the first year a part of the capitalization is again allowing an opening for "water" and introducing the circle of capitalizing earnings at the ordinary rate of profit and then arguing that the profits are fair because they are no more than the ordinary rate of profit upon the capitalization.

The biggest loophole, however, to public service corporations for watered capitalizations has been in the matter of franchises. As to the legality of capitalizing franchises there are confused opinions. One of the most recent and skillfully reasoned cases along this line is that by Judge Hough in the Consolidated Gas case cited above. Along one line of unusually sound reasoning based upon facts and good economics he reaches the conclusion that a franchise is not a productive factor in earning wealth and is not entitled to a return. But then he turns around, saying that it is his duty as a judge to follow previous decisions, and upon an equally learned line of reasoning of these cases he finds that a franchise is productive property, and so productive that, in this case, it is worth $12,000,000, which amount should be added to the capital account from which a fair return may be lawfully demanded. This two-fold conclusion is well worth examining.

Reasoning to the first conclusion, the judge says the claim to demand a return not only upon tangible assets but also upon the franchise, the right under which the plant operates, is, as an original proposition, unsound. Return can only be expected from an investment, and he that invests must part with something. He that hath not sown shall not reap. The complainant did not invest in the franchise because it did not pay for it. The investment was not made in the franchise but under it and in faith thereof. A franchise has no value in itself, no inherent value, and its asserted value is only a duplication of the value of the tangible property operating under it. Such things as land, money, and chattels, when combined with industry and intelligence, may be made productive. But a franchise is non-productive. When it is combined with the above productive qualities, their earning capacity is no greater than before; for the franchise has added no productive power to the reality or personality; it has but authorized their employment in a particular way and protected the owners while so employing them.

"On every private sale of franchise property, the price paid," the judge says, "is so much money lost to official incompetence or worse, and such sale can confer on the vendee no right to compel the consumer to repay him a price which should have been paid to the State. For these reasons I believe that on principle a franchise should be held to have no value except that arising from its use as a shield to protect those investing their property upon the faith thereof, and that, considered alone and apart from the property which it renders fruitful, it possesses no more economic value for the investor than does an actual shield possess fighting value, apart from the soldier who bears it."[77]

At this point the argument changes to the legal side wherein the judge continues: "It is familiar doctrine that private citizens may acquire vested property rights through a series of even erroneous decisions; rights so firmly vested that it becomes unconstitutional for the court which persisted in error to suddenly rectify its mistakes to the detriment of those who had securely rested upon the decisions sought to be invalidated. In this case I am compelled to the conclusion that it is necessary to allow the discoverable value of complainants' franchise as a part of that capital upon which a fair return must be allowed, because to refuse would disregard views expressed by higher courts regarding the general nature of franchises and regulation of proceedings."

It is thus because of "views expressed by higher courts" that franchises are valuable. And because of this the judge, after reviewing a long line of cases, feels himself compelled to consider franchises "not only as property but as productive and inherently valuable property." Therefore, he finds the franchise in this case to be worth $12,000,000 which he adds to the capital account upon which complainant is allowed to charge rates so as to yield a profit of six per cent.

Hence the argument is essentially that "upon principle" the franchise is non-productive, has no economic value, and should therefore not be allowed to yield a

[77] 157 Fed. 873-4.

return; but upon law, "erroneous decisions," and in order not so "suddenly to rectify" previous mistakes which investors had considered valid, the "franchise is productive and inherently valuable property."

The argument upon law seems to have so much right that, where the courts and legislatures have made mistakes and the people have taken the decisions as valid and built a definite commerce upon them, they should not rectify these too suddenly but bring about the correction gradually so as to give the people time to make the necessary readjustments without too serious losses. Now it appears that the Consolidated Gas Company had at one time capitalized, under the legal sanction of the State, its franchises to the amount of about $7,000,000. But Judge Hough increased this to $12,000,000, his argument being that the intangible assets may be taken as increasing in the same proportion as the real estate or tangible assets. This certainly is following the policy of not "suddenly to rectify mistakes"; but one fails to see why a retaining of the old capitalization would not have been a better step towards a correction of them.

To us Judge Hough's argument "upon principle" seems wholly conclusive. A franchise is not a factor in production. When combined with land, capital, and good managerial ability, it adds nothing to their economic products. It is simply a license to certain individuals for carrying on a public business under specific conditions, conferring upon the grantee the protection of the law, and, in case of municipal public service companies, its protection against injury and loss by competition, giving them the power of monopoly in their special locations. Because it is a license from the State to perform a public function, it should not be made a subject of commerce; for this is allowing private individuals to confer public rights and privileges. This is politically objectionable, for a private individual may not select a person that is acceptable to the State. Besides, in a democracy the people have reserved in their sovereign the right of conferring public rights and privileges. If the sovereign confers this power upon private individuals without his subjects' consent, it is a violation of his trust and appears quite as dangerous as it would be to allow a license to marry to be made a subject of commerce, or for a mayor of a city to sell his office to one of his friends.

In addition to the political objections to making a franchise a subject of commerce, there are objections of common sense. A public business is usually profitable, especially when it is a monopoly. To have the State pay a public servant for the privilege of licensing him to carry on a profitable business is contrary to good business sense. In private business, if one individual confers upon another the privilege of conducting a profitable business, the grantee must pay for it, usually in the form of rent. If the grantee should get his privilege free, he would have good reason to be grateful and it is unlikely that he would ask the grantor to pay him for the privilege of giving him gifts. There is no reason why democracies and their officers should not exercise as much common sense as the average man in private business. If they should do so, we would have no more merchandizing in franchises. Instead of having the State pay the public servant for the privilege of giving him gifts, we should have the payments made in the other direction; and I believe we should find many business men willing to pay for a license to carry on a profitable business, especially when it is a monopoly and so is protected against injury and loss by competition.

When the Supreme Court heard the Consolidated Gas case, it apparently appreciated the force of Judge Hough's argument upon principle. It reduced the value of the franchise to its former capitalization of $7,000,000, and allowed this to be added to the capital account as a special case, since the State had permitted this capitalization and could not therefore take it back again. It must bear the consequences of its own mistakes. That the franchise had a capital value solely on this account is evident from the reasoning of the court. Aside from such circumstances, we may take it for granted that the Supreme Court recognizes no capital value for franchises. And it is worth while mentioning that in a very recent case, January 1911, before the Supreme Court of California, that for franchises and also "going value" to have capital value it was ruled that it is necessary "to furnish data showing that these elements had a distinct independent, productive value, before such value could be included." It is scarcely necessary to say that these data were not furnished. Thus, finally, we have a court basing value upon principle, expressing no regard for the precedent of erroneous decision.

The ruling, or at least the tendency, of the courts is, then, to recognize that only that which has distinct productive value can be included in the capital account upon which a fair return may be lawfully expected. Capital must represent some tangible investment, and in investing the investor must part with something, either money or money's worth. Such items as location, good will, going value, and good management have value only in so far as they affect earnings and, as such, are justly included in the market or sale value of a business or provided for in the rate of profit, but are not included in the basic valuation by which the reasonableness of rates are to be determined. Good will exists only in a competitive business, and a franchise should have neither market nor capital value, but is the peculiar right of the sovereign who is entitled to all its benefits beyond a fair wage to the public servant.

SECTION IV. *How the Courts have Determined a Fair Profit.*

What constitutes a fair return is more difficult than what is a fair capitalization upon which to base that return. Upon this point the courts have ruled that it should depend upon the degree of risk; that a business is entitled to a larger return than a mere investment, such as in government bonds, because of the greater risk; that the rate of return upon any one business should be determined by what investors usually expect and receive in other businesses in the same locality involving an equal amount of risk.[78] And six per cent

[78] *Consolidated Gas Company v. City of New York*, 157 Fed. 871; *Ibid.*, 212 U. S., p. 49.

has been considered a fair return for a public service corporation in New York.

The objection might be made that if all our railroads had been limited to this rate of return, not a single railroad could have been built in the United States; that originally railroad securities were a doubtful investment and that, therefore, bonds for construction had to be sold at a large discount, and besides much bonus stock had to be given; that a railroad requires several years to build and several years more to secure a regular and permanent trade; that during these years interest must be paid on bonds; but it cannot be paid out of earnings, since there are none, and must therefore be paid out of the capital account; that because of these reasons usually not more than two-thirds of the par value of the bonds goes into actual construction; and that the constitutional return upon the physical valuation of the railroad's property ignores all these preliminary expenses without which a railroad cannot be built.[79] To this it need only be replied that cost of reproduction by no means necessarily includes such considerations, and to say what is a fair return for an established monopolistic business is not the same as saying what is a fair return for a new untried business. As the Supreme Court has said, the rate of return should be proportional to the degree of risk or safety, which implies that a new business should be allowed sufficient inducement to attract the necessary capital. But to allow original preliminary expenses and risk to be made a permanent charge upon the capital, no matter how

[79] See *Railroad Age Gazette*, June, 1908, p. 365.

safe it becomes, is unnecessary. The railway pioneers should be rewarded for their ventures and losses; but that all future generation should be made to pay for these risk strikes are as an undue demand upon their gratitude. For such losses and ventures, a comparatively large return for the first few years might be allowed, but after that it could be limited to what the public regards as a fair return upon the invested capital.

SECTION V. *Factors Determining the Development of Judicial Opinions upon Rate Charges and the Relation of these Opinions to the Charging-what-the-traffic-will-bear and Cost-of-service Principles.*

While the above line of cases for the determination of a fair basis upon which a fair rate may be calculated is not free from criticism, no one can read them and deny that they do not represent a sincere effort to meet the demands of the situation and solve the obligations and problems put upon them by considering railroads as coming under public law. In the beginning, although it was agreed that a railroad is entitled to a fair return upon the value of the property used for the public convenience, there was a division as to what constitutes either a fair return or value. But since the fairness of the earning was in question, it became clear that this could not be tested by the value of the property if this value itself was determined by the earning, and, for this reason, it was agreed that value was determined by cost of reproduction. The fairness of earnings was not settled by any definite principle except local custom. These rulings are not determined by precedent or by what had been forbidden or enjoined in the past but rather by the facts of the immediate situation. They show clearly that there is no such thing as the Law, fixed, unchangeable, and eternal, governing the case; but, on the contrary, the law is something flexible, growing, and adaptible to immediate and practical conditions. Of course, there are general rules governing all these cases, and the most fundamental of these is that railroads are public servants, and the aim of these cases is to find out what is a fair wage for them as public servants. But this general law is itself flexible and allows different specific laws for different specific situations.

I have quoted rulings not fully in agreement with the above remarks. The ruling of Judge Hough on franchise is an instance. This opinion represents the conflict between precedent and fact in the mind of an individual judge, a conflict which is usually represented by different individuals. On the one hand, Hough is constrained to follow law and precedent, even the precedent of erroneous decisions. On the other hand, he is constrained to follow principle and fact. In so far as he follows the former, he is merely making additions to erroneous decisions and creating confusion in the situation with which he is dealing. In so far as he follows principle and fact, he reaches a conclusion which is new, constructive, and in the interest of the public. The opinion shows clearly on which side progress and construction is made.

Put in a general form what the decisions viewing the railroads as governed by public law come to, is that the fairness of rate charges is determined by cost of service. On the other hand, those defending rate discriminations and viewing the railroad business as private, argue in agreement with the principle that charging what the traffic will bear gives a fair rate. What I wish to make clear on the one hand, is the necessity of charging what the traffic will bear in a competitive business, and, on the other hand, the equal necessity of the cost-of-service principle in a monopolistic and public business. Each principle functions satisfactorily in its proper situation. If carriers are in free and open competition, it is supposed in theory, as well as in practice, that each of them will make the rate the lowest possible in order to get the largest possible volume of business. That is, each carrier, because of the force of competition, will make the rate as low as the cost of service profitably allows. But, if a carrier has a monopoly, then, charging all that the traffic will bear, becomes a principle of extortion. Before a consumer will do without shoes or a coat or bread, he will pay the highest rate his earnings will bear, and, under these conditions, the carrier has power to extort most of his earnings that are not necessary for a living. That is, he has the power to reduce the consumer to a condition of servitude. A principle allowing such a result would be condemned as not functioning satisfactorily, at least not to the satisfaction of the public. In a monopoly, then, the old rule of competition is a failure, and the question is *how much* should the traffic *fairly* bear, a question which cannot be answered except by reference to the cost of service, because the check of competition has been removed. It is for this reason that recent decisions have approved the cost-of-service principle. The early decisions that applied the common law to the public carrier made the common mistake of applying old rules to changed conditions that required new rules.

CHAPTER III

THE CHANGE FROM PRIVATE TO PUBLIC MORALS WITH LARGE INDUSTRIAL COMBINATIONS

SECTION I. *The Effect of the Adoption of the Methods and Practices of Private and Competitive Business by Large Industrial Corporations.*

In Chapter I, we pointed out the result of carriers bargaining privately with combinations and of adopting a principle of charging what the traffic will bear, which is the competitive principle of charging all you can get as applied to transportation. In this chapter I shall take up this principle as applied to the sale of commodities and show the results of it when adopted by combinations and applied in a way that is common between individual traders in competition. It must be remembered that this principle means low prices at competitive points and high prices at noncompetitive points through which the losses on the former are recouped. This system of charging is local discrimination when adopted by a single individual or combination. As adopted by combinations, it has been an important cause of monopoly, although this is little understood by the public. It will, however be made clear by telling what the practice has meant to the two monopolies recently ruled upon by the Supreme Court, viz., the American Tobacco and Standard Oil monopolies.

An illustration of one of the methods of the American Tobacco Company for killing competition is supplied by the story of its fight against the Nashville Tobacco Works. The latter company had been doing a prosperous business for about fifteen years. Its leading brand was a 3 by 12 dark plug called "Old Statesman." Against this, the American Tobacco Company put out another dark plug, of the same size, weight, and quality, called "Bulls Head." Old Statesman sold regularly for 39 cents a pound, but by a scheme of discount Bulls Head sold for 16 cents a pound, a price below cost of manufacture. The business of the Nashville company soon began falling off; and by the end of 18 months, its owners became convinced that they must either sell or lose all. Accordingly, their plant was secretly sold to the American Tobacco Company.[1]

This was a common mode of procedure for the American Tobacco Company, which could well afford to sell one of its brands below cost in a competitive territory, for in numerous other places it had a monopoly which more than offset the loss. But the competitor, being confined to a comparatively narrow territory, could not recoup himself in this manner and so had to give up, even though he could manufacture just as cheaply as his conqueror.

The American Tobacco Company defended this scheme by pleading that it carried on its business in its own way without reference to competitors. Their destruction was only incidental. What the consumer wanted was not the tobacco but the *brand*. However,

[1] Puryear, IV, 165-181.

to introduce a new brand, it had to be sold at low prices. If the American Tobacco Company occasionally sold at low prices, it was merely to get a new brand on the market. However, one may interpret the defense of the scheme, it cannot be denied that its objective effect was the killing of competition and the establishment of a monopoly.

But possibly the clearest illustration of local price-cutting, is found in the history of the Standard Oil Company. In the previous chapters, I described briefly how the Standard gained its monopoly largely through advantages in transportation. But, after its monopoly had been established, local price-cutting was the principal method of maintaining it.

In the footnote below I present a table showing the price of Standard Oil in each of the states, and the lowest prices in each as taken from the United States Report on the Petroleum Industry, 1907. It will be seen that the price of oil is 7.7 cents per gallon in Deleware, 8.5 cents in Ohio, 8.7 cents in Pennsylvania, and 8.9 cents in Connecticut; but 14 cents in Oklahoma, 15.7 cents in Washington, 16.4 cents in Nevada, and 16.6 in Colorado. Here the low and high prices are in widely separated geographical points. But the conspicuous differences are also found within the same state. For example, in Massachusetts the price is 7.4 cents at Blackstone and 10.9 cents at Plymouth; in Louisiana 7 cents at New Orleans and 15.5 cents at Payne; and, in New Mexico, 9.6 cents at Lascruces and 22.8 cents at Charma. Sometimes a river or a street between two purchasers is sufficient to make a difference in the price of oil.[2] In Windsor, Mass., oil sold at 8 cents but at Windsor Hill, across the river, it sold for 9 cents. In Windsor Locks, Conn., the American Whiting Paper Company paid 9½ cents but the grocery stores in the same town paid only 7½ cents.[3] In Pittsfield, Mass., the Standard tank-wagon driver offered to fill the tanks of two merchants free of charge, but other merchants he charged 7½ cents a gallon.[4]

Table I, showing price of oil in states and towns of various sizes in the U. S.

State	Average for state (cents)	Lowest price per gal. (cents)	Highest price per gal. (cents)
Maine	10.4	9.5	11.3
New Hampshire	10.3	9.8	10.8
Vermont	9.0	8.0	00.2
Massachusetts	9.9	7.4	10.9
Rhode Island	9.6	8.4	9.9
Conneticut	8.9	7.9	9.8
New York	10.0	8.3	11.6
New Jersey	9.8	8.3	11.3
Pennsylvania	8.7	8.0	10.6
Delaware	7.7	6.9	8.7
Maryland, District of Columbia	9.2	8.2	10.1
West Virginia	9.0	8.1	9.5
Virginia	9.7	7.3	10.7
North Carolina	10.3	8.0	11.9
South Carolina	10.8	10.0	12.1
Georgia	11.6	8.2	13.4

[2] Hisgen, Record, 4/1820-1.

[3] Hisgen, Record, IV/1820-1.

[4] Record, Dean, 4/1895; Mandigo, 4/1963-66; Couch 4/1968.

Table I Continued

State	Average for state (cents)	Lowest price per gal. (cents)	Highest price per gal. (cents)
Florida	12.8	11.5	13.9
Ohio	8.5	6.4	11.2
Indiana	9.5	7.7	10.5
Illinois	9.1	7.5	11.5
Michigan	9.0	7.7	10.7
Wisconsin	9.2	7.2	11.2
Minnesota	9.6	7.8	12.0
Iowa	10.2	8.7	11.2
Missouri	10.9	9.0	16.4
North Dakota	11.1	10.3	11.5
South Dakota	12.9	10.3	16.8
Nebraska	10.5	8.8	12.8
Kansas	11.4	8.7	13.0
Kentucky	9.4	6.4	10.7
Tennessee	11.6	8.8	13.0
Alabama	11.6	9.7	13.0
Mississippi	9.8	7.7	12.3
Louisiana	9.5	7.0	15.5
Arkansas	13.9	8.9	16.5
Indian Territory	12.5	10.9	14.1
Oklahoma	14.0	13.1	14.3
Texas	11.6	9.0	14.8
Montana	15.6	12.7	17.6
Idaho	15.6	13.6	18.8
Wyoming	15.6	13.5	16.9
Colorado	16.2	14.3	23.4
New Mexico	13.2	9.6	22.8
Arizona	10.7	....	....
Utah	14.8	14.1	16.0
Nevada	16.4	....	....
Washington	15.7	14.0	17.8
Oregon	15.3	14.0	17.7
California	11.1	6.1	14.5

Table I Continued

Total number of states	49
Total number of states reporting both lowest and highest price	47

Computed from tables 146, 143, 132, U. S. Report on the Petroleum Industry, 1907.

What was the cause of this great variety in prices which the Standard charges? The fact that oil sold for 9.3 cents per gallon more in Nevada than in Delaware makes one wonder whether the difference might not have been due to geographical conditions, possibly to a greater cost of marketing or of refining, or it might have some relation to the density of population. But when geographical differences are reduced to such narrow limits as a river or a street, and when the same oil out of the same tank-wagon was sold at greatly varying prices, one becomes suspicious of the adequacy of such explanation and is inclined to look for some other principle, possibly competition.

Transportation charges do not explain the variety in the prices quoted because they have been previously deducted. Refining costs are no sufficient explanation, because the variety is the same in the prices of oil from the same refinery. For example, oil from the refinery at Whiting, Indiana, sold for 9 cents in Michigan and for 13.7 cents in Araknsas; oil from the refinery in Richmond, Cal., sold for 7.2 cents in Southern California and for 15.7 cents in Washington.[5] Marketing costs explain part of the variety in different localities, but in no case a greater difference than 1.86 cents a

[5] S. II, Table 133.

gallon, which amount represents the difference between the marketing costs in Southern California, 1.36 cents a gallon,[6] and 3.22 cents a gallon, the cost in South Texas. Density of population, of course, can explain nothing in itself. If this makes any difference, it must affect either marketing costs or competition. But what marketing costs explain is already stated. It remains to consider competition.

In the footnote below, two tables are presented showing the relation between marketing costs and margins on the one hand, and the amount of competition on the other. Table II gives the prices and margins on oil in 23 towns where the Standard had no competition, and those in 12 towns which had from 30 to 50 per cent competition. In the 23 towns having no competition, the average price is 12.87 cents a gallon and the average marginal gain is 2.52 cents. But in the 12 towns which had competition, the average price was only 9.09 cents while there is a marginal loss of .08 cents a gallon. Table III gives the margins and the per cents of competition at 22 main and substations of the Standard Oil Company. The Standard generally has a main station, for the storage and delivery of oil, in some large city. From this it supplies sub-stations in smaller neighboring towns. Frequently it happens that there is considerable competition at the main station while there was little or none at the sub-station. In 20 out of the 22 sub-stations named, the table shows that where competition is higher at the main than at the sub-station, the margin is correspondingly lower,

[6] *Ibid.*, Table, 134.

and in a number it was less than nothing. These results point clearly to the conclusion that competition is the cause of the various prices which the Standard Oil Company charged for its oil.

Table II, showing price and margins on oil according to degree of competition.

Towns having no competition	Cents Per gallon	
	Price	Margin
Brockton, Mass	11.0	2.18
Fall River, Mass	10.5	2.15
Lynn, Mass	11.0	2.61
Providence, R. I.	10.0	1.21
Altoona, Pa	11.0	2.98
Columbia, S. C.	13.0	2.27
Atlanta, Georgia	13.0	1.98
South Bend, Ind	10.0	1.90
Grand Rapids, Mich	9.5	1.14
Mankato, Minn	11.5	2.24
Davenport, Iowa	10.0	.75
St. Joseph, Mo	11.0	1.52
Fargo, S. D	13.5	2.10
Nashville, Tenn	12.0	2.11
Denver, Col	16.0	3.39
Leadville, Col	20.0	5.47
Pueblo, Col	16.0	3.38
Seattle, Wash	15.5	4.17
Spokane, Wash	21.5	6.10
Tacoma, Wash	15.5	3.99
Portland, Ore	15.0	4.12
Sacramento, Cal	13.0	2.45
San Diego, Cal	9.5	1.30
Averages	12.87	2.62

Towns having 30-50% competition	Cents Per gallon	
	Price	Margin
Birmingham, N. Y.	9.5	1.00
Pittsburgh, Pa.	8.5	.87
Toledo, Ohio	9.5	1.63
Peoria, Ill.	9.0	.35
La Crosse, Wis.	9.0	.17
Milwaukee, Wis.	8.5	.65
Wichita, Kans.	10.0	.48
Los Angeles, Cal.	7.5	-3.16
Cincinnati, Ohio	7.0	1.09
Minneapolis, Minn.	9.5	.24
Des Moins, Iowa	10.75	.53
New Orleans, La.	9.5	1.35
Averages	9.09	.03

Computed from Record, Petitioners' Exhibits, 390.

Table III, showing prices and margins of oil at main and sub-stations in relation to competition.

Division	Cents Margin at		Percentage of competition	
	Main stas.	Sub-stas.	Main stas.	Sub-stas.
Baltimore	0.09	1.36	16.5	7.1
Cincinnati	(1.09)	0.65	45.3	7.2
Cleveland	(0.16)	1.68	11.7	20.0
Decatur	0.08	1.66	12.9	4.6
Des Moines	0.53	1.47	41.8	12.7
Dubuque	(0.19)	1.88	55.1	10.3
Duluth	0.88	2.52	9.9	4.6
Evansville	0.05	1.30	29.0	10.4
Indianapolis	0.12	1.02	22.0	9.0
Kansas City	0.27	1.71	24.2	3.8
La Crosse	0.17	1.82	38.6	1.5
Louisville	(0.38)	1.42	16.1	3.7
Memphis	0.18	2.10	27.6	4.5
Minneapolis	0.24	1.52	41.8	0.7
New Orleans	(1.35)	0.46	51.2	6.5
Omaha	0.41	1.32	21.7	5.3
Peoria	0.55	1.68	31.2	12.9
Richmond	(0.27)	2.03	12.0	5.5
Sioux City	0.44	1.87	23.6	5.4
Springfield, Mass	(0.88)	1.19	21.7	8.6
Wichita	0.48	2.63	32.1	3.6
Worcester	0.08	1.45	5.0	6.5

Computed from Record, Petitioners' Exhibit 634.

At this point, it will be interesting to see how the method of price-cutting worked in the concrete. A few illustrations will make the process clear.

In the early part of 1900, Hisgen Brothers erected storage tanks in Albany, N. Y., for the purpose of going into the oil business. When this fact became known, the Standard at once dropped the bottom out of the prices. Oil declined from 12 cents a gallon to 8½, 8 and 7 cents. Hisgen Brothers could not meet these prices and had to refrain from marketing oil in Albany for two years.[7] In the meantime, they began to work the surrounding towns. In these places, oil was high and they could market it at a good profit.[8] When they sold in a town to some particular dealers, the Standard men would soon visit these dealers, cut the prices to them, but maintain the high price to the others not visited by the Hisgens.

In 1901 one of the Hisgens made a trip down the Hudson and visited the towns along the river. Here he found oil selling between 3 and 4 cents higher than in Albany. He sold oil to the dealers at their Albany price plus the cost of freight, his selling point being that if they would give him an order, the Standard would soon sell to them cheaper. His prophecy proved true, for, immediately after, a Standard man visited those dealers and lowered the price. Hisgen was able to sell to a dealer once or twice but after that the trade went back to the Standard because of the low price.[9] Therefore, the Hisgens had to go into new territory and repeat the same experiences. After their visit, the prices would always fall two or three cents a gallon and in many cases the Hisgens had to drop out of a town. In some, where the people had the good sense

[7] Record, 9/1947.

[8] Record, 4/1803-04.

[9] Record, 4/1813-15; 4/1977-78.

to appreciate competition, they could hold the trade at a higher price than the Standard's. For example, when the Hisgens entered Springfield, Mass., oil was selling at 12½ cents per gallon; but, in a few weeks, the price went down to 9 cents and then, ½ cent at a time, until it reached 7 cents. The Hisgens met the cut until it reached 7½ cents, and, at that price, they appealed to the trade to stand by them. The dealers did so, since they appreciated that the prices were lower than they would be in case of no competition.[10]

By 1902 the prices in Albany had again gone up to about 9 or 10 cents. When the Hisgens again began to sell oil in Albany, the price again dropped, to 6 and 6½ cents.[11] The Hisgens, however, kept on at 7½ cents. To a customer of the Hisgens the Standard now made individual cuts in an attempt to take the trade away from them. To one, Winnie,[12] they made a cut of ½ cent a gallon, but Winnie, appreciating the value of competition, refused. To another, Ahearn,[13] they made a cut of 2 cents below the prevailing price for six months and succeeded.

Another town in which the Standard's method of price-cutting is characteristically illustrated is Augusta, Georgia, where the Standard disposed of four competitors one after the other. On the first man to begin competition, namely J. T. Thornhill, they cut the price from 17 to 11½ cents a gallon; and in a year,

[10] Record, 4/1817.

[11] Record, 4/1813-15.

[12] Winnie, Record, 4/1933.

[13] Ahearn, Record, 4/1970-72.

ready to quit, he moved away.[14] The next competitor was Blodgett, Moore, and Co., that opened a branch in August about 1888. After withstanding the Standard's price-cutting for about two years, this company sold out to them.[15] Afterwards, the price went up from 6½ and 7½ to 14½ cents. When the third independent, the Tidewater Oil Company of New York, ventured to do business in Augusta, the Standard cut the price on them 8 cents a gallon, from about 14 to 6 cents. At the end of about a year and a half they sold out to the Standard and moved away.[16] The fourth company to attempt to compete with the Standard was Crew, Sevick, and Company. But this was a short-lived concern, and was finished up in about a year, after which it too quietly moved away.[17] These illustrations suffice to show the Standard's method of price-cutting. A competitor comes into a town. A cut in price follows. The competitor goes out. The price goes up again.

This policy is well described in the testimony of Mr. Boardman, who was at one time an employee of the Standard in Augusta:

J. "What was done when a company would come in there?"

A. "Cut the price."

J. "How much?"

[14] Boardman, Record, 5/2166.

[15] *Ibid.*, 5/2166.

[16] Boardman, Record, 5/2167.

[17] *Ibid.*

A. "As much as necessary to get the business. It would depend on what we thought the other fellow would be able to do. . . . Say they figured this fellow's oil would cost him 12 cents in barrels; they would make it 11½—fix it so that he couldn't sell oil at a profit if possible."[18]

This policy is still better described by Mr. Jennings, a director of the Standard Oil Company, in a conversation he had with Mr. Todd, who was competing with the Standard in Troy, N. Y. Mr. Todd reported their conversation in his testimony, and it is so important as to be well worth quoting:

"My talk with Mr. Jennings was that I considered the business . . . we were conducting at that time . . . a foolish one. After I got through, he said: 'The argument you put up, Mr. Todd, I can't meet . . . it is all on one side, but you have got to take into consideration that the Standard Oil Company have to operate differently from what a small concern would, We have got a policy to pursue and that is to make it just as difficult for an independent to put out oil as we possibly can; in other words, we want to drive them out of business if we can; if we can't, why we sometimes make a dicker; but our first move is to make it just as expensive as we can. Now,' he says, 'you can readily see this, because, if we didn't where would we be in a few years? The independents would have the bulk of the business.' He says, 'That is our policy.' "[19]

[18] Boardman, Record, 5/2165.

[19] Todd, Record, 6/3215-16.

Table IV — showing price of oil in various towns before and after competition by Standard, and effect on competition.

Town	Reference in Record	Price per Gallon (cents) before competition	after competition	Date	Result to Competitor
Albany, N.Y.	Hisgen 4/1948	12	8, 8½, 7	1900	....
	Hisgen 4/1816	9,10	6, 6½	1902	....
Springfield, Mass.	Hisgen 4/1817	12½	9-7	1901	Continued at 7½
Thompsonville, Conn.	Hisgen 4/1817	10, 11	7	.....	Continued at 7½
Windsor Locks, Mass.	Hisgen 4/1818-20	10, 11	7, 7½	.....	....
Griffville, Conn.	Hisgen 4/1821-24	11	8½	1906	....
Cheshire, Mass.	Hisgen 4/1826-27	x	x-1 or 1½	1905	....
	Dean 4/1892-93				
Pittsfield, Mass.	Dean 4/1895-99	10, 10½	7½	....	Continued at 9
	Mandigo 4/1963-66				
Long Meadow, Mass.	Hisgen 4/1828	8, 8½	6	....	Compromise
	Allen 4/1900				
Boston, Mass.	Todd 6/3216-18	10	6½	1897	Compromise
Troy, N. Y.	Messner 20/44	9	7½,7,6½	1900	....
Binghampton, N. Y.	Todd 6/3220-21	x	y	.....	Sold 5 stations to
New Windsor, Md.	Metzel 5/2413	x	0	1898	....
Augusta, Ga.	Boardman 5/2166	14	6	1889	Sold out to S.
Augusta, Ga.	" 5/2172	14½	9	1904	Continued at 9, S. 11
Atlanta, Ga.	" 5/2174	12	9½	1906	....
Denmark, S. C.	" 5/2175	15	11½	1906	Continued 12, S. at 11½
Washington, Ga.	" 5/913	15	5	1898[1]	Driven out
Atlanta, Ga.	Wooten 5/2096	x	6½	1897	Sold to S.
	Wooten 5/2101	13	9	1901	Driven out, 15 after
Birmingham, Ala.	Wofford 5/2156-57	14	13, 12, 11	1904	Sold to S.
Cleveland, Ohio	Castle 6/3054-57	x	x-2	1900	Compromise
Chardon, Ohio	Hossler 6/2941-43	12, 10	10, 8	1901	....
Portland, Mich.	Gamerl 6/3134-41	12	6	1905	....
Pierce City, Mo.	Hopkins 3/1028-29	x	x-½	....	....
Dexter, Mo.	Lederer 3/1044-46	20	12,10,5	1898	Driven out

[1]Approximately.

An idea of the extent of the practice of cutting the price on the competitor may be seen from Table IV, which gives some instances as reported by witnesses in the case of the Standard Oil Company v. the United States. This table gives the prices before and after competition began in a town, the date, and the result to the competitor when reported. It is largely such instances as these that account for the price variation of Standard oil. By this time, our general conclusion must be clear that it is competition that explains the differences in the price of Standard oil throughout the United States.

A supplementary method with which the Standard Oil Company used to meet cut-price conditions was to employ bogus independent companies. These were operated by an agent of the Standard who represented himself to the trade as an independent having no connection with the Standard; but as a matter of fact he sold Standard oil and operated under policies dictated by the refined oil department of the Standard. The bogus company, after starting, usually cut the price at once so as to get the trade back to the Standard, often taking advantage, however, of the very prejudice against trusts to get this custom. It could also make rebates and concession in special cases. It solicited in most part the trade supplied by independents with just enough of the Standard trade to keep up the appearance of its supposed independent character. By employing these bogus companies, the Standard would need to lower prices only in those particular districts of a town or territory where there was competition but could keep them up elsewhere. The Standard thus avoided the obligation of lowering its prices over large districts and met competition in the least expensive way. About 60 bogus companies were reported by witnesses in the Standard Oil suit. These operated at competitive points in 20 different states.[20]

A second supplementary method which the Standard used for cutting prices was to give rebates to the purchasers of oil. The rebate was given to a dealer or peddler in consideration that he sell oil at a low price named by the Standard, or that he agree to buy his supplies from the Standard for a certain length of time, or to keep him from "going over the line," buying from a competitor. The rebates usually ranged from ½ to 2 cents a gallon. As a rule, the dealer paid the open market price to the tank-wagon man and received his rebates from "a sort of special man in the rates department with duties directly under the manager."[21] A third supplementary method employed by the Standard for cutting prices was a peculiar system of espionage. It would require fully twenty pages to describe this method with any accuracy, but, suffice it to say here, it was one of the best organized departments in the Standard Oil Company. In its New York office alone, the department which has charge of this system had a force of 38 clerks. The system was carried out by means of special arrangements not only with Standard employees but also with employees of railroads. Deputy

[20] Mahle, Record, 5/2353. Also Petitioners' Brief of Facts, Vol. II, pp. 115-149.

[21] Castle, Record, 6/3030.

public oil inspectors frequently assisted, and occasionally employees of independent companies. Judge Woodson of the Supreme Court of Missouri, in the course of an elaborate opinion upon the Standard Oil Company, covering over 450 printed pages, describes the effects of this system as follows:

"In order to drive out all competitors and drive out the entire trade, they inaugurated and carried on a perfect system of espionage, by which they acquired complete knowledge of their competitors' business, and followed almost every barrel of independent oil shipped over a railroad to the very door of the dealer, and, there, by means of cutting prices, offering rebates, misrepresentation and deception, attempted to have the sale countermanded and prevent him from purchasing independent oil in the future."[22] This brief statement must be satisfactory for our present purposes.

By such methods as these, the Standard Oil Company was able to maintain its monopoly of the oil business. I do not mean to give the impression that the Standard did not also employ excellent technological methods. It excells in the latter. The Standard's competitors, as well as the best of the large corporations, have much to learn from the Standard in the way of technological excellence and sound economic management. Nor do I intend to give the impression that the Standard alone practiced these competitive methods. I chose the Standard as an example for showing gen-

[22] *State ex inf. v. Standard Oil Co.*, 218 No. 1, 444. For system see Petitioners' Brief of Facts, Vol. II, pp. 358-428. For the case see *St. Oil Co. v. U. S.*, 22 1 U. S., 1.

eral practices prevailing in corporate business, with the hope of making clear their significance to the public welfare, namely, the establishing of a monopoly when practiced by a large combination against small traders. If this is their effect the question is whether such methods are unfair. If so, how shall we draw the line between fair and unfair competition? These questions will be discussed in the next section.

SECTION II. *A Review and Criticism of Judicial Opinion upon the Morals of Monopoly and Competition.*[22a]

The problem set by the last chapter cannot be solved without an appreciation of the changing character of morals, how they originate and change with reference to the environment or situation in which they function, and what the moral and logical grounds are justifying such changes. These matters will be fully discussed in connection with the analysis of our problem.

Underlying the changing character of morals is the conception that new conditions require new rules. It usually happens that when the conditions suddenly change old rules are applied unaltered, and are allowed to work serious havoc before their inertia is overcome and an effort made to formulate rules fitting the new situation. This state of affairs applies in particular to the morals of competition and monopoly. Within the last half century there has been an unrivaled development of industry from a simple agricultural stage to the extreme form of the factory system, or from industry as carried on by individuals each according to his

[22a] Reprinted from the author's paper, "Morals of Monopoly and Competition," *Int. J. of Ethics*, Jan. 1915.

preference to a condition of industry carried on by the combined efforts of many men resulting in large combinations and monopolies. But there has been no corresponding change in business methods or morals. On the contrary, competitive morals have been applied without alteration to conditions of monopoly and combination. This mis-application resulting from the unequal evolution between business morals and business conditions appears to be the fundamental cause of our present monopolies and other industrial problems engaging the serious efforts of our legislatures and courts. I hope to make this clear in the body of this section.

The opinion is often expressed that the so-called laws of competition have existed since time out of mind, are a part of the order of nature, and as such are unchangeable. There are a few old cases, however, which show that such a view is contrary to fact, that the competitive system grew out of previous monopolistic conditions fostered by the medieval guild system and by royal grants. It was welcomed because it was thought a vast improvement upon the old system and in the interest of the public. Beale and Wyman, writing of the governmental regulation of business during the late middle ages say: "Not only did the law regulate business indirectly through the courts, parliament itself frequently regulated prices of the necessaries of life by direct legislation. The great staples like wool and food were habitually regulated in this way, and the employment and the price of labor was a subject of statutory provision. Thus, in 1366, Henry III, after reciting former statutes to the same effect, regulated the price of bread and ale according to the price of wheat and barley, and forbade forestalling, that is, cover ing the market. In 1344 the ordinances fixing the export prices of wool were repealed after some years of trial. In 1349 all laborers obliged to serve for the customary wages and 'butchers, fishmongers, regrators, hostelors (i. e., innkeepers), brewers, bakers, poulterers, and all other sellers of all manner of victuals' were bound to sell for a reasonable price.[23] These statutes continued in force throughout the middle ages, and until the settlement of America." The explanation of this regime is to be found in the economic conditions of the times.—The respective business men had a practical monopoly in their own localities. To prevent extortion or refusal of service, either of which might be very damaging to a customer, the state had to undertake legislation. So far as a single case is evidence, a breaking away from these conditions began with the Schoolmaster's case in 1410.[24] The masters of a grammar school in Gloucester brought a complaint against another master, and said that the defendant had started a school in the same town, so that whereas formerly they had received 40 d. a quarter from each child, they now got only 12 d. to their damages. Their counsel contended that this interference and damage made a good action, and cited many instances of exclusive rights, especially the claim of the masters of Paul's that there should be no other masters in all London except themselves. But Justice Hill denied the claim of the plaintiffs since they had no estate but a min-

[23] Railroad rates regulation, p. 7.

[24] Y. B. II Henry IV, 47, 21.

istry for the time; and though another equally competent with the plaintiffs came to teach the children, "this was a virtuous and charitable thing, and an ease to the people, for which he could not be punished by the law."

It would be difficult to find a better illustration of the fact that competition was welcomed because it was "an ease to the people." But, without going into further detail upon the origin of the system of free competition, it may be said that in course of time there developed a fixed set of morals, customs, and habits which became crystallized into the common law and which represent what seems almost the apex of individual liberty. To give an idea of the wide range of liberties allowed in competition by the American common law, we may refer to the recent case of *Citizens' Light, Heat, and Power Co. v. Montgomery Light and Power Co.* The contestants were competitors in furnishing light, heat, and power to the people of Montgomery. The defendants induced customers of plaintiff to break their contracts with it, made false statements about its credit and service, and frequently took business below cost in order to take its trade away. The court gave judgment for the plaintiff on the first count, but for the defendants on the other two, Judge Jones saying: "At common law, a trader, or persons in other callings, in order to get another man's customers, could use any means not involving violation of the criminal laws, or amounting to 'fraud,' 'duress,' or 'intimidation,' as the law understands and applies these terms to transactions between man and man, or to his becoming a wrongful party to a breach of another man's contract. The trader may boast untruthfully of the merits of his wares, so long as it does not take the form of false statements, amounting to slander or wilful misrepresentation of the quality of a rival's products, or a libel upon the character, business standing, and credit of his rival, or an effort to induce the public to believe that the product he sells is that manufactured and sold by the rival. He may send out circulars, or give information verbally, to customers of other men, knowing there are bound by a contract for a definite term, although acting with the purpose of getting the trade of such a customer. He may use any mode of persuasion with such a customer, keeping within the limitations stated, which appeal to his self-interest, reason or even his prejudices. He may descant upon the extent of his rival's facilities compared with his own, his rival's means, his insolvency, if it be a fact, and the benefits which will result to the customer in the future from coming to the solicitor rather than remaining where he is. He may lawfully, at least so far as his rival is concerned, cut prices to any extent, to secure his trade. So long as what he does is done to the benefit of his own trade and, in taking over the customers of another, he keeps within the limits heretofore defined, he is safe from legal restraint at the instance of a competitor in following 'the law of competition'; which takes little note of the ordinary rules of good neighborhood, or abstract morality. The person whose customers are thus taken from him cannot complain, for no right of action lies in his favor against him who solicited his customer, since the solicitor exercised a legal right in a legal way.[24a]

The judge giving this opinion has lost sight of the public interest in the competitive system which was originally designed for its benefit. He takes no account of common morality. He simply states what the common law allows and gives his decision accordingly, which is clearly a definite crystallization of the *laissez faire* policy in business. The liberties which he allows function well in such a competitive system in which they developed. The traders were small, had approximately equal resources, and each one was more or less for himself. If one trader cut prices, or gave rebates, or granted special favors to particular customers, or slandered his rival, or boasted untruthfully on the merit of his wares, his competitors could do likewise with equal effect. If a customer could not get satisfactory terms from one trader, he could do so from another. The public took no interest in a war of competition except to get the advantage of good bargains. If anyone was injured, it was the trader rather than the consumer. There were, of course, evils such as numerous bankruptcies and periods of under- and over-production, but, on the whole, the system was worth more to the public than it cost, and one positive merit that it did have was that it allowed full freedom to individual capacity and ingenuity.

But, if we introduce into this competitive system of approximately equal individual traders, a large combination of traders having an enormous capital, then

[24a] 171 Fed. 553.

the competitive morals as practiced between the combination and individual trader have an altogether different effect because of the inequalities in capital. In a siege of price-cutting, in getting information of the competitors' business from their employees and from those of the railroads, in securing favorable advertising in the form of disinterested news and editorials, in securing favorable legislation and able lawyers and solicitors, and in delaying litigation by appeals, and in many other instances the combination can get advantages which are wholly denied to the small trader because of his small capital. The small trader may be a better manager than anyone in the combination, he may produce cheaper, treat his customers more considerately, give prompter service, and offer a superior quality of goods, but, no matter what his merits are, he cannot possibly overcome the superior capital of the combination which, as a consequence, secures a monopoly. It, then, has power to oppose the public with unreasonable prices through which it may recoup the losses from the war of competition. When such a result occurs, we begin to hear of "unfair competition," "cut-throat and predatory competition," "tainted money," "anti-trust legislation," "the extortion of monopolies," "restraint of trade," "reasonable and unreasonable restraint of trade," and such phrases which indicate that a problem has arisen in the public consciousness and that moral feelings have been aroused. The old adage "competition is the life of trade" begins to have an unsavory sound and these so-called laws of competition which existed since time out of mind begin to be questioned. The combination is dubbed an "Octopus." But, as a matter of fact, the combination has done nothing more than carry out the "good old-fashioned laws of competition," the very same methods practiced daily by those who raise the bitter cry against it. The only difference is that the combination got all the gain and the little trader went to the wall. The question arises, however, whether a combination can rightfully adopt the same methods practiced by small traders in competition and whether its large capital does not create a new situation in which the old morals of competition fail to function and whether the combination should not adopt a new set of morals commensurate with its new situation. Here there is clearly a moral problem and, to show the form which it has taken, we can do no better than to refer to some court decisions on the matter. We may guess that the conservatives on competition will think the old system of competition good enough, while those enlightened on new conditions will recommend a change. I shall first quote some opinions from the former class. We shall find that they are averse to make distinctions between kinds of competition and believe competition, as such, a part of the unchangeable order of nature. The Mogul Steamship case, the leading case on competition in England, gives the general trend of the conservatives' views. In this case, the defendants, who were firms of shipowners trading between China and Europe, formed themselves into an association, from which the plaintiffs were excluded, the purpose being to obtain a monopoly of the tea trade and maintain freight rates. They offered a rebate of five per cent to shippers who consigned their tea exclusively to their (the defendants') vessels, and also to send special ships to under-bid any vessels which the plaintiffs might send. Defendants reduced rates so low that plaintiffs were obliged to carry at a loss in order to obtain homeward cargoes. To recover their losses, they brought suit for damages. Lord Morris, in his judgment, said: "I am not aware of any stage of competition called 'fair' intermediate between lawful and unlawful." The Lord Chief Justice Coleridge said: "It must be remembered that all trade is and must be in a sense selfish; trade, not being infinite, nay, trade of a particular place or district being possibly very limited, what one man gains another loses. In the hand-to-hand war of commerce . . . men fight on without much thought of others, except a desire to excel or defeat them. Very lofty minds, like Sir Philip Sidney with his cup of water, will not stoop to take an advantage, if they think another wants it more. Our age, in spite of high authority to the contrary, is not without its Sir Philip Sidneys; but these are counsels of perfection which it would be silly indeed to make the measure of the rough business of the world as pursued by ordinary men of business."[25] Lord Justice Fry said: "I know no limits to the right of competition in the defendants—I mean, no limits in law. I am not speaking of morals and good manners. To draw the line between fair and unfair competition, between what is reasonable and unreasonable, passes the power of the

[25] 21 L. R. Q. B. D., 553-4.

courts. Competition exists when two or more persons seek to possess or enjoy the same thing: it follows that the success of one must be the failure of another—and no principle of law enables us to interfere with or to moderate that success or that failure so long as it is due to mere competition."[26]

Lord Justice Bowen gave the clearest exposition of the common law on this subject. He said in part: "We are presented in this case with an apparent conflict or antimony between two rights that are equally regarded by the law—the right of the plaintiffs to be protected in the legitimate exercise of their trade, and the right of the defendants to carry on their business as seems best to them, provided they commit no wrong to others. . . . What, then, are the limitations which the law imposes upon a trader in the conduct of his business as between himself and other traders? . . . No man, whether trader or not, can . . . justify damaging another in his commercial business by fraud or misrepresentation. Intimidation, obstruction, and molestation are forbidden; so is the intentional procurement of a violation of individual rights, contractual or other, assuming always that there is no just cause for it. The intentional driving away of customers by shew of violence;[27] the obstruction of actors on the stage by preconcerted hissing;[28] the disturbance of wild fowl in

[26] 23 L. R. Q. B. D., 625-26.

[27] *Tarleton v. M'Gawley, Peak N. P. C.*, 270.

[28] *Clifford v. Brandon*, 2 Comp. 358; *Gregory v. Brunswick*, 6 Man & G., 205.

decoys by firing guns;[29] the impeding or threatening servants or workmen;[30] the inducing persons under personal contracts to break contracts;[31] all are instances of such forbidden acts. But the defendants have been guilty of none of these acts. They have done nothing more against plaintiffs that pursue to the bitter end a war of competition waged in the interest of their own trade. . . . To say that a man is to trade freely but that he is to stop short at any act which is calculated to harm other tradesmen, and which is designed to attract business to his own shop, would be a strange and impossible counsel of perfection. But we are told that competition ceases to be a lawful exercise of trade . . . if carried to a length which is not fair or reasonable. The offering of reduced rates is said to have been "unfair." This seems to assume that, apart from fraud, intimidation, molestation, or obstruction of some other personal right, there is some natural standard of "fairness" or "reasonableness" (to be determined by the internal consciousness of judges and juries) beyond which competition ought not in law to go. There seems to be no authority . . . for such a proposition. It would impose a fetter upon trade. . . . And what is to be the definition of a "fair profit?" It is said it ought to be a normal rate of freight, such as is reasonably remunerative to the shipowner. But over what period of time is the average of this reasonable remu-

[29] *Carrington v. Taylor*, 11 East 571; *Keehle v. Hickering*, 11 E st, 574.

[30] *Garret v. Taylor*, Cro. Jac. 567.

[31] *Bowen v. Hall*, 6 Q. B. D., 333; *Lumley v. Gye*, 2 E. & B. 216.

nerativeness to be calculated? All commercial men are acquainted with the ordinary expedient of sowing one year a crop of apparently unfruitful prices, in order by driving competition away to reap a fuller harvest of profit in the future; and until the argument at bar, it might be doubted whether shipowners or merchants were ever deemed to be bound by law to conform to some imaginary "normal" standard of freights or prices, or that Law Courts had a right to say to them in respect of their competitive tariffs, "Thus far shalt thou go and no further." To attempt to limit English competition in this way would probably be as hopeless an endeavor as the experiment of King Canute. . . . Assume that what is done is intentional, and that it is calculated to do harm to others. Then comes the question, Was it done with or without just "cause or excuse"? . . . legal justification would not exist when the act was merely done with the intention of causing temporal harm, without reference to one's own lawful gain, or the lawful enjoyment of one's own rights. . . . But if the real object were to enjoy what was one's own, or to acquire for oneself some advantage in one's property or trade, and what was done was done honestly, peacably, and without any of the illegal acts above referred to, it could not in my opinion, properly be said to be done without just cause or excuse."[32]

Along the same line as this opinion have been numerous American decisions. The following cases indicate the lower limits to which competition may go in America.

[32] 23 L. R. Q. B. D., 614-16 618-19.

In *Bohn Mfg. Co. v. Northwestern Lumbermans' Association*, a number of retail dealers in lumber combined for the purpose of preventing wholesale dealers in lumber from selling directly to the consumers or other non-dealers in localities where a member of the association did retail business. Judge Mitchell upheld the association, saying: "What one man may lawfully do singly, two or more may lawfully do jointly. The number who unite to do the act cannot change its character from lawful to unlawful. The gist of a private action for the wrongful act is not the combination or conspiracy, but the damage done or threatened to the plaintiff by the acts of the defendants. . . . It can never be a crime to combine to commit a lawful act, but it may be a crime for several to conspire to commit an unlawful act, which, if done, by one individual alone, although unlawful, would not be criminal."

In *Macauley Brothers v. Tierney*, the members of a national association of plumbers agreed not to buy from wholesale dealers who sold to plumbers not members. Chief Justice Matteson justified the action, saying: "Competition, it has been said, is the life of trade. . . . To hold such an act wrongful and illegal would be to stifle competition."[33] . . .

In *National Protective Association v. Cumming*, where contestants were competing organizations of steam-fitters, defendants caused the discharge of plaintiffs by the threat of a strike. Chief Justice Parker justified the conduct of defendants mainly on the grounds of competition, that an organization may lawfully do what an

[33] 19 R. I., 225.

individual may lawfully do. The following extract indicates the ground of his decision: "A man has a right, under the law, to start a store and to sell at such reduced prices that he is able in a short time to drive the other storekeepers in his vicinity out of business, when, having possession of the trade, he finds himself soon able to recover the loss sustained while ruining the others. Such has been the law for centuries. The reason, of course, is that the doctrine has generally been accepted that free competition is worth more to society than it costs, and that on this ground the infliction of damages is privileged."[34]

An unusually vigorous defense of competition is found in a Standard Oil case decided in West Virginia. Defendant, the Standard Oil Company, built a pipe line through the territory of the plaintiffs' line, and then refused to buy oil from producers unless they shipped it through their own line, and also refused to buy any oil shipped through plaintiffs' line. This ruined the business of the plaintiff. Judge Brannon held such conduct not actionable. He said: "This is the act of persons and corporations, by union of means and effort, drawing to themselves, in the field of competition, the lion's share of the trade. This is not a monopoly condemned by law. The lion has stretched out his paws and grabbed in prey more than others, but that is the natural right of the lion in the field of pursuit and capture. Pity that the lion exists, his competing animals may say; but natural law accords the right, it is given him by the maker for existence. The state made the

[34] 170 N. Y., 315.

Standard Oil Company, and gave it the right of being and working. . . . The defendant companies were all in common interest. Could they not unite to further their interests? Could not the Standard Oil Company buy from whom it chose? . . . Cannot the village merchant say to the farmer, "I will not buy your eggs unless you buy my calico?" Cannot the big mill owner refuse to buy wheat from those who do not ship it over a railroad or steamboat owned by him? . . . Now, these companies were furthering their interests in lawful competition with others. . . . That, in these days of sharp ruinous competition, some perish is inevitable. The dead are found strewn all along the highways of business and commerce. Has it not always been so? The evolution of the future must answer. What its evolution will be in this regard we do not yet know, but we do know that thus far the law of the survival of the fittest has been inexorable. Human intellect—human laws—cannot prevent these disasters. The dead and wounded have no right of action from this imperious law. This is a free country. Liberty must exist. It is for all. This is a land of equality, so far as the law goes, though some men do in lust of gain get advantage. Who can help it?"[35]

From these cases, it is possible to form an idea, not only of the particular acts allowable in competition, but also of the general principles on which they are permitted. The former have been sufficiently reviewed. The latter seem to fall into three classes: competition is morally right because: (1) it is the right of individual

[35] 50 W. Va., 611.

freedom, and what individuals may do singly they may also do jointly; (2) it is based upon natural right and the law of the survival of the fittest, an order of nature created by the maker; (3) it is for the best interests of society, being worth more than it costs. These principles are but reflections of a competitive, industrial society which has been defended ever since Adam Smith's "*Wealth of Nations.*" But within the last fifty years, there has been a rapid change in the industrial order; a change from individual, competitive, and small-scale production to coöperative, monopolistic, and large-scale production; a movement from an undirected, unorganized, and separate control of the many to the directed, organized, and unified control of the few.

The judiciary has begun to appreciate the significance and tendency of this movement. Accordingly, we have a number of cases in which the judges have ceased justifying acts of trade simply because they are due to mere competition, but have carefully considered whether a given act is for the best interests of society, whether it tends toward monopoly, or is only in reasonable restraint of trade.

Without going into details, it may be said in a general way that the principles upon which this new line of decisions is based began to be laid down in the English case of *Mitchel v. Reynolds* in 1712. The defendant leased his bake-shop in the parish of St. Andrew's Holborn, to plaintiff for a period of five years, and upon a bond of fifty pounds, agreed not to open a new shop within this time. But he broke his agreement and was sued. Parker, C. J., decided in favor of the plaintiff because the contract was limited to a particular place and offered a sufficient consideration to the defendant. But a contract restraining trade generally throughout the kingdom "must be void, being of no benefit to either party and only oppressive"; and "the true reasons" for judging voluntary restraints of trade are: "first, the mischiefs which may arise under them, first to the party, by loss of his livelihood, and the subsistence of his family; secondly, to the public, by depriving it of a useful member."[35a]

The principles for judging a contract in restraint of trade are more clearly stated in *Horner v. Graves*, 1831. The contestants were dentists. Defendant, who was a moderately skillful dentist, agreed not to practice independently within a radius of 100 miles from York, in consideration of entering the service of plaintiff for five years at a salary of 100 pounds per year, to be increased annually; but within three months he started independently within the prohibited distance. Counsel for defendant argued: "If the Plaintiff were to labor night as well as day, it would be physically impossible for him to draw all the teeth of such a district. If he leaves home, York is without the benefit of his skill; if he remains at York, patients may die at Lancaster . . . the health of the public is endangered, without the possibility of any advantage to the Plaintiff. The agreement is therefore unreasonable and void."

Tyndall, C. J., agreed with counsel, and out of these petty facts, developed a most significant principle for

[35a] 1 p. wms. 181.

distinguishing between reasonable and unreasonable restraint of trade, and one which has been frequently affirmed in American decisions upon questions of monopoly. He said: "And we do not see how a better test can be applied to the question whether reasonable or not, than by considering whether the restraint is such only as to afford a fair protection of the interests of the party in favor of whom it is given, and not so large as to interfere with the interests of the public. Whatever restraint is larger than necessary for the protection of the party, can be of no benefit to either. It can only be oppressive; and if not oppressive, it is, in the eye of the law, unreasonable. Whatever is injurious to the interests of the public is void, on the grounds of public policy."[36]

In these two cases we have laid down the fundamental principles for the regulation of monopolies and restraint of trade, a half century before the problem existed in its modern form. The public interest should be the controlling factor in determining the reasonableness of a contract in restraint of trade. Monopoly or total restraint of trade is against the public interest and is unlawful. But a partial restraint of trade, if it allows a fair consideration for the contracting parties and no more than is necessary for their protection, is reasonable and good. If it produces a greater protection than necessary, it is oppressive and void. It remains only to define more specifically what constitutes monopoly and public interest, and by what principle we may

[36] 7 Bing., 733, 743.

determine what a fair protection is for the contracting parties.

The definition of monopoly and of public interest is rather concretely stated in *Morris Run Coal Company v. Barclay Coal Company*, decided by the Supreme Court of Pennsylvania in 1871. Five coal companies organized a selling agency which had control of the production of the respective companies and could fix prices. Judge Agnew said: "When competition is left free, individual error or folly will generally find a correction in the conduct of others. But here . . . they have combined together to govern the supply and the price of coal in all the markets from the Hudson to the Mississippi river. . . . The public interest must succumb to it for it has left no competition to correct its baleful influence. . . . The domestic hearth, the furnaces of the iron master, the fires of the manufactures all feel its restranit. . . . Such a combination is more than a contract,—it is an offense. . . . Every "corner," in the language of the day, whether it be to affect the price of articles of commerce such as breadstuffs, or the price of vendible stocks, when accompanied by a confederation to raise or depress the price and operate on the market, is a conspiracy."

In another coal case, *Pocahontas Coke Co. v. C. & C. Co.*, where 20 coal operators combined in a similar form as in the case above, monopoly is still more clearly defined. Judge Cox said: "If the direct and necessary and natural effect of a contract or combination among producers and sellers of a commodity is to restrain competition and control prices to the injury of the public when all the powers of the contract or combination shall have been exercised, the contract or combination is in unreasonable restraint of trade and against public policy. . . . A contract which is charged to be in restraint of trade is not to be tested by what *has been* done under it but what *may* be done under it."[37]

The definition of monopoly is now clear. The test of a monopoly or contract in restraint of trade against the public interest is power or tendency to control prices.

Another basic principle of numerous recent decisions against monopolistic practices was laid down in Massachusetts by Chief Justice Shaw in *Commonwealth v. Alger*, 1851. The question was whether an owner of land along the seashore might extend a wharf beyond a limit prescribed by the legislature, if it neither obstructs navagation nor is a public nuisance. Justice Shaw did not permit the exception since this would confuse the law, and the law he upheld on this ground: "We think it a settled principle, growing out of the nature of well-ordered civil society, that every holder of property, however absolute and unqualified may be his title, holds it under the implied liability that his use of it may be so regulated, that it shall not be injurious to the equal enjoyment of others having an equal right to the enjoyment of their property, nor injurious to the rights of the community. All property in this commonwealth . . . is derived directly or indirectly from the government, and held subject to the common good and general welfare. Rights of property, like

[37] 60 W. Va., 508, 524-5.

other social and conventional rights, are subject to such reasonable limitations in their enjoyment . . . as the legislature, under the governing and controlling power vested in them by the constitution, may think necessary and expedient. . . . The power we allude to is . . . the police power, the power vested in the legislature by the constitution, to make, ordain, and establish all manner of wholesome and reasonable laws statutes and ordinances, either with penalties or without, not repugnant to the constitution, as they shall judge to be for the good and welfare of the commonwealth, and of the subjects of the same."

The good of the subject of the state or the public interest also formed the basis of a dissenting opinion of Lord Esher in the Mogul Steamship case already referred to. He said: "Unless the public has an interest in traders being left to their own judgment, and to a free course of trade, there is no foundation for the law as to agreements in restraint of trade being illegal. It follows, if the agreement be an agreement to violate the right of an independent trader by restraining his trade, there is a sufficient public interest which is also injured, and the agreement is an indictable conspiracy. . . . If one goes beyond the exercise of the course of trade . . . his act is an unlawful obstruction. . . . The act of the defendants lowering their freights far beyond a lowering for the purpose for any trade—that is to say, so low that if they continued it, they themselves could not carry on the trade—was not an act done in the exercise of their own free right of trade, but was an act done evidently for the purpose of interfering with—

the plaintiff's right to a free course of trade, and was therefore a wrongful act."[38]

The principle that property rights proceed from the state and must be used for the common good of its subjects received a new interpretation in a recent Massachusetts case, *Martell v. White*, having special bearing upon competition. The question was whether a voluntary association of granite-workers could, by a system of fines, prevent members from trading with plaintiff, not a member of the association, and so ruin his business of quarrying granite. The court denied the right, Judge Hammond saying: "To what extent combination may be allowed in competition is a matter about which there is as yet much conflict, but it is possible that, in a more advanced stage of the discussion, the day may come when it will be more clearly seen and will more distinctly appear in the adjudication of the courts than as yet has been the case; that the proposition that what one man lawfully can do, what any number of men acting together by combined agreement may do, is to be received with newly disclosed qualifications arising out of the changed conditions of civilized life and of the increased facility and power of organized combination, and that the difference between the power of individuals, acting each according to his preference, and that of an organized extensive combination may be so great in its effect upon private and public interests as to cease to be simply one of degree and to reach the dignity of a difference in kind. . . . The right of competition rests upon the doctrine that

[38] 23 L. R. Q. B. D., 606-10.

the interests of the great public are best subserved by permitting the general and natural laws of business to have their full and free operation, and that this end is best attained when the trader is allowed in his business to make free use of these laws. . . . But from the very nature of the case it is manifest that the right of competition furnishes no justification for an act done by the use of means which in their nature are in violation of the principle upon which its rests."[39]

Here, then, we have a clear grasp of the modern situation and a clear recognition that changes in the conditions of civilized life call for equal changes in business methods and principles applicable to these changed conditions, that although it may be logically inferred that what one man may do singly he may also do jointly with others, results may prove this an invalid conclusion, and the difference in conditions may be so important as to make the inference impossible.

Summing up the new line of cases that we have reviewed upon the limits of competition, we may draw the boundaries as follows: The legitimacy of a given business method, or use of property, or contract in restraint of trade is to be determined by reference to the public interest or good of society, from which all rights are derived. Monopoly or contracts in restraint of trade giving the parties concerned the power or possibility of controlling prices are against an individual by a combination which aims to destroy his business by a mere agreement not to trade with him, or by going beyond the ordinary course of trade, such as

[39] 185 Mass., 255, 259-61.

doing business at a loss—is against the public interest and unlawful. Under the police power, the legislature may pass any laws limiting methods of business and uses of property to any extent which they deem necessary for the welfare of the people.

It would be quite impossible to enumerate all the particular acts declared illegal both by statutes and courts within the limits thus drawn. But the mentioning of a few that some courts have prohibited may aid in getting a clearer idea of unfair competition. A manufacturer or seller may not give rebates to the purchasers of his commodities for the purpose of maintaining and fixing prices.[40] He may not sell goods lower at one place than at another for the purpose of destroying competition. He may not compel dealers not to purchase or deal in the goods of a rival so as to have him deal in his own exclusively.[41] He may not follow the employees of a rival and harass them while engaged in the discharge of their duties. He may not publish false and injurious reports about his rival.[42] He may not fix the prices and conditions under which dealers should sell his goods.[43] A seller as a member of an association of retail dealers may not refuse to sell goods to a non-member, or charge him

[40] *State v. Standard Oil Company*, 218 Mo., 1,442.

[41] *People v. Duke*, 44 N. Y. Supp., 336; *Commonwealth v. Strauss*, 191 Mass. 545. *Cibley v. United Shoe Machinery Co.*, 152 Fed., 726.

[42] *Standard Oil Co. v. Doyle*, 118 Ky. 622.

[43] *Cont'l Wall Paper Co. c. Voight & Sons*, 212 U. S. 227; *Dr. Miles Med. Co. v. Pork & Sons Co.*, 220 U. S. 873.

higher prices than a member,[44] nor compel wholesale dealers not to sell goods to nonmembers.[45] And, as a member of a monopoly, he may not charge more than competitive prices for his goods under penalty of treble damages.[46]—All such acts are forbidden as tending toward and establishing a monopoly. But any contract in restraint of trade, or method of business is permitted by the courts when it is not a part of a monopolistic scheme nor is likely to produce such a result.

When we consider that hardly a one of these acts would be denied to an individual acting singly for his own interests, and compare them with acts prohibited and acts allowed by the common law as expounded by Lord Justice Bowen or Judge Jones, both of whom we have quoted, it becomes apparent what a remarkable change has taken place from the business methods of individual competitive bargaining to those of coöperative and monopolistic bargaining. The courts apparently do recognize a difference in kind between the acts of individuals acting alone and the acts of individuals acting as a combination. The query now arises what are the conditions which account for this difference, and which do not allow individuals to do jointly what they may do singly. What is the difference between competition as carried on by a combination and as carried on by an individual?

[44] *Montague & Co. v. Lowry*, 193 U. S. 38.

[45] *Cleland v. Anderson*, 66 Neb. 252.

[46] *Chattanooga Foundry Co. v. Atlanta*, 203 U. S. 390.

Lord Justice Bowen said the Mogul Steamship case presented "an antinomy between two rights equally regarded by the law—the right of the plaintiffs to be protected in the leigitmate exercise of their trade, and the right of the defendants to carry on their business as seems best to them, provided they commit no wrong to others." *Did* defendants commit any wrong to others? The judge answers the question by taking a *backward* look. He finds that in 1620 it was forbidden to drive workmen and servants away from a rival by threatening to cut their arms off; that in 1706 it was forbidden to fire with guns into a man's decoy pond for the sake of frightening away his fowl; that in 1804 it was forbidden to drive a rival's customers away by shooting them with cannon; that in 1810 it was declared illegal to drive actors from the stage by preconcerted hissing; and that in 1853 it was forbidden for a third party to induce the breaking of personal contracts. "But the defendants," he says, "have been guilty of none of these acts. They have done nothing more against the plaintiffs than to pursue to the bitter end the war of competition waged in the interest of their own trade." If they had no such interest to maintain, and if they had injured plaintiff for the mere sake of the injury, it would have been unjust. But, since it was done for the maintenance of their own interests, it was just and lawful. Lord Esher, however, looks at the question from an opposite point of view. He takes a *forward* look and considers whether such competition is compatible with the public interest and welfare. He does not see that there can be any permanent gain to the public in destroying a useful trader by doing business at a loss, as the defendants did, and therefore gives judgment for the plaintiff.

Thus the solution of the antinomy between equal rights turns upon the point of view of the judge. Does the act come within the scope of acts classified as wrong in the past? If not, it is right. Or does it tend to further or hinder the public good? If the former, it is right; if the latter, it is wrong. Which of these two views is based on the better ethical and logical principle?

The first essential in deciding this issue is a keen consciousness of the different logics used in these two lines of cases. It is significant that on both sides there are judges who say that the standard of reference is the public interest. The conservatives argue in syllogistic fashion as follows: Competition is the life of trade and in the interest of the public. This is an act of competition and therefore in the interest of the public. This reminds one of Aristotle's logic, but it is not in agreement with his ethics in which he says that knowledge is virtue provided it was knowledge of the major and minor premises in their proper relationship. I rather think Aristotle was right. You must be sure of your major premise and then that the minor comes within its major before it is possible to draw a proper conclusion. The difficulty with the conservative judges is that they do not examine their premises, whether they are true or not. They assume in their major premise that competition is the life of trade, is an eternal law of nature. They then merely determine whether the case at bar is a case of competition. If it is, it must be a part of the eternal order, and therefore privileged. They make no effort to distinguish between kinds of competition, and assume with equal naïveté that to distinguish between fair and unfair competition passes the power of the courts and of the human understanding.

In contrast to such a naive syllogistic procedure, is the logic underlying the opinions of the liberal judges. For want of better terms, I shall call this the functional, genetic, evolutionary, historical, or situational logic. For the sake of brevity, I shall restrict myself to the term functional. According to this method in ethics, we take the view that morals are group habits formed to meet the requirements of a particular situation and are right, or function satisfactorily, when they satisfy the wants of the group in that situation. If a conflict arises, we should discover the conditions out of which it arose, find out how the old system of morals originated, analyze the situation in which it functioned, and find out the elements which made the old system satisfactory, analyze the new elements in the changed situation which impair the usual functioning of the old morals, then project an hypothetical solution, keeping the good of the old system as much as possible and making changes only for the new elements, and, finally, try out the proposed solution in a practical way.

In agreement with this method, we have found that the competitive system grew out of ancient conditions of monopoly and was approved by the judge of the transition period because it better satisfied the interests of the public. It did this because it allowed free range to individual incentive and capacity; and success depended, among other things, on good management, prompt service, considerate treatment of customers, ability to produce and sell goods of a quality and price demanded by the customers, and on capital, which however, was only one element. With reference to the traders, the system was a success because they were approximately equal in capital; and one could play "the rule of the game" as effectively as the other. Under such conditions, competition was the life of trade, that is, on the whole it was worth more to the public than it cost. When, however, a combination is introduced into these conditions, then success depends principally on the single element of capital against which the other elements of success in the small trader are of little avail. Competition, as between the combination and the individual trader, instead of being the life of trade, becomes the restraint of trade, the outcome of which is inimical to the interests of the public.

When, under these conditions, a judge tells us that what is right for an individual is also right for a combination, he is unconsciously basing rights upon the single element of capital. He fails to see that this element in the combination destroys all the other values of the competitive system. He assumes that a difference in magnitude does not produce a difference in kind and he is led into this assumption because in law both the individual trader and the combination possess the common name of "person." When, however, the individual person and the corporate person are analyzed and the elements of success in each are made distinct, then such propositions fall to the ground. In general, the judge who commits such fallacies fails to analyze the situation in which the morals in question function. He is satisfied to refer to cases which have nothing more in common than some problem of competition, and then to argue that, if in the case at hand, nothing was committed that was forbidden in the past, the act complained of is just and lawful. This sort of procedure is quite correct when the cases referred to and the act in question present identical situations. It is then a matter of prudence to apply to the present situation what has proved successful in identical situations in the past, and, only when such a motive is present in the consciousness of the judge, is this reference to past cases profitable. But the judge who says that what is lawful for individuals is lawful for combinations wholly ignores their respective situations and deals only with rules in the abstract. He assumes that an old competitive rule must *ipso facto* apply to a competitive situation, forgetting that one competitive situation may be wholly different from another. A judge proceeding in this way, rather than take the pains of analyzing the differences in situation, which make a rule right in one case and wrong in another, will rather devise new arguments in defense of the old rule such as "the survival of the fittest," "the interests of the stronger," "the right to pursue trade for one's own interests," and so on. We may accept these arguments and assume with them that right is with the stronger, if we remember that both individuals and combinations are members within the state, which, being the strongest of all, may, on Judge Brannon's principle of "natural law," crush either individuals or combinations, provided it is for the state's "own interest." These would be "natural" acts; for, if the acts by which a combination destroys competitors are "natural," the acts of the state, which is the mother of the combination, cannot be other than "natural."

It is not necessary to say more in criticism of the conservative opinions. They are based on fallacies, and, of such fallacies, monopolies are an expression. How they are, we have indicated above. I wish, however, to make clear the merits and reasonableness of the opinion of the liberal judges. They are conscious of the grounds upon which laws are based, and, that this consciousness is a fundamental cause of these enlightened opinions, is evident to everyone who reads them. An equally fundamental factor is that they study, not only the concrete situation in which the laws in question function, but also their concrete effects upon society. It is this which reveals to them that a difference in magnitude makes a difference in kind and that a changed situation demands a new rule. This is not derived from *a priori* and syllogistic reasoning, but is made evident by inductive reasoning from experience, from facts of observation. And, by analogy, if birds must have a different sort of locomotion in the air than on the earth, and, if fishes must breathe differently from horses, it is not unreasonable that large combinations should have a different method of conducting business than small traders. In all cases, it is the changed situation that demands a new behavior. Morals are no exception to the functional character of biological behavior of which they are a part. To know this fact is more important in the administration of justice than to know law. What judges need is not so much a knowledge of law as a knowledge of philosophy, and by philosophy in this connection I mean a knowledge of the principles, logical and ethical, upon which morals are based, on awareness of the proper sort of methodology in practical reasoning.

Aside from the matter of methodology, the issue in conflict of these cases is whether business is a matter of private interest and of private law, or a matter of public interest and public law. The conservative judges take the former view; and the liberal judges the latter view. The conservatives, therefore, do not see a difference in kind between the business of a private individual and that of a large combination. The liberals say that, because business is affected with a public interest, the combination cannot refuse service to anyone, but must, without discrimination, serve all who apply; and further that it cannot destroy competition by doing business at a loss. The difference in magnitude between a private individual and a corporation is important here. When a corporation becomes so large that its capital, business organization, and number of employees equals that of the government itself, and, when it supplies an article of necessity to every community throughout the state's territory, it holds within its grip the fortunes of individuals quite as much as the state itself, and is equally affected with a public interest. To anyone alive to modern conditions, there can be no doubt that business combinations should come within the public law and perform their duties with the same sense of obligation as the state itself; that is, give service to all impartially and without discrimination. Such a régime has, besides the economical advantage by compelling both combination and individual to succeed on their merits, for it allows the individual to engage in business beside the combination, provided he can produce just as cheaply and sell at the same margin of profit. If, however, the individual trader cannot succeed under these conditions, it is difficult to see how the public is benefited by his retention. The state then might allow monopoly and check the competition on prices by government regulation.

I cannot properly conclude this section without raising the question of the meaning of public interest, which is the ethical criterion used by the liberal judges and also referred to by one of the conservative. That an adequate analysis of this concept is necessary is evident because different judges come to opposite conclusions in reasoning from the same standard. This must be the case so long as its meaning is left to individual opinion.

CHAPTER IV

The Change from Private to Public Service Methods in Determining Prices[1]

We have seen that the tendency of the liberal judges, quoted in the last chapter, is to treat large industrial corporations as affected with a public interest and impose upon them the same restrictions and obligations as are now imposed upon public service corporations like the railroads. If this view should be generally accepted, the courts will have the additional obligation to determine what fair prices are for the commodities of these corporations, just as they had to determine what fair rates are for a railroad. Little has been done in this direction, but the conflict will be the same as in the previous cases; that is, whether large industrial combinations should continue to charge all that the commodities will bear, the principle of competitive and private business, or whether they should base their prices upon cost of production, the principle of public service business. In order to decide upon this issue, we must again review the conditions that are supposed to determine fair prices in competition and then examine how these conditions are changed in a monopolistic business.

Section I. *The principle for determining a fair price under competition.*

In the competitive system it is supposed that charging all you can get in an open market determines a

[1] A partial reproduction of the author's paper, "The Combination versus The Consumer," *Int. J. of Ethics*, Jan. 1913.

fair price. In Adam Smith's system, such a price was called the natural price of a commodity and covered the cost of bringing an article to market, including subsistence for the wage-earner, subsistence for the trader, and the ordinary rent to the land-owner. The relations of supply and demand tended to keep the market price at the level of the natural price. Adam Smith's argument for this tendency is as follows:

"If at any time it (the quantity of any commodity) exceeds the effectual demand, some of the component parts of the price must be paid below their natural rate. If it is rent, the interest of the landlords will immediately prompt them to withdraw a part of their land; and if it is wages or profit, the interest of the laborers in the one case, and of their employers in the other, will prompt them to withdraw a part of their labor or stock from this employment. The quantity brought to market will soon be no more than to supply the effectual demand. All the different parts of the price will rise to their natural rate, and the whole price to its natural price. If, on the contrary, the quantity brought to market should at any time fall short of the effectual demand, some of the component parts of the price must rise above their natural rate. If it is the rent, the interest of all other landlords will prompt them to prepare more land for the raising of this commodity; if it is wages or profit, the interest of all other laborers and dealers will soon prompt them to employ more labor and stock in preparing and bringing it to market. "The quantity brought thither will soon be sufficient to supply the effectual demand. All the different parts of the price will soon sink to their natural rate, and the whole price to its natural price.

"The natural price, therefore, is as it were, the central price to which the prices of all commodities are continually gravitating. Different accidents may sometimes keep them suspended a good deal above it, and sometimes even force them down below it. But whatever may be the obstacles which hinder them from settling in this center of repose and continuance, they are constantly tending towards it."[2]

A modern version of this argument with its ethical bearings is given by President Hadley: "The idea that each article has a value or just price based on its cost of production, and that the trade is moral or immoral according as the trader based his charge upon this cost, was at one time quite universal and is held by many persons even at the present day. . . . To begin with, while it makes provision against extortionate profits by the trader on some articles, it does not say how he is to be protected against losses on others. What will happen if buyers are not prepared to pay a price for the article which covers the cost of production? You cannot compel a man to purchase when he would rather go without the articles than pay the price charged. You cannot compel the trader to leave the goods unsold on his shelves because the just price is not forthcoming. You must let him sell at a loss. But if he sells some things at a loss and is only allowed a fair profit on others, his business in general is a

[2] *Wealth of Nations*, Cannan's edition, pp. 59, 60.

losing one. He must be allowed to make extra charges on the things that the public will buy, to make up for his failures on the things the public will not buy.

"But there is a deeper practical difficulty than this. The attempt to prohibit a trader from selling an article for more than it cost may become disadvantageous to society as a whole. Take a concrete case, which was frequently occurring in mediæval communities. There is a scarcity of wheat and a deficiency in the bread supply. Those who have the wheat or the bread to sell are anxious to put the price up. They are not allowed to do it. The church threatens them with everlasting penalties in the next world, and, more immediate if not more important, the magistrates threaten to cut off their ears in this. Of course, the price stays where it was. No man is going to imperil his soul's salvation and his ears at the same time. The consequence is that, as long as the supply lasts, the consumption of bread goes on at the same rate as before. Then there is a sudden and appalling famine in which whole villages are desolated. Contrast the working of the modern principle of letting people charge what they can get. Those who own the food supplies raise their prices as soon as they see the scarcity threatening. This enhancement of price causes people to be more economical in the use of bread, so that the old supply lasts longer. It also gives people a motive to arrange for the importation of wheat from other markets in time to prevent the most acute forms of famine. Of course, there is some hardship. The poor feel the increased price of bread acutely; and when they see that this price goes to swell the profits of traders who had more money than the consumers to begin with, they are more jealous of the injustice. But the moderate hardship to the consumer when the price of bread begins to rise prevents the awful and appalling loss which he would suffer in seeing his children die before his eyes if all the bread in the community were used up; and the extra profit to the seller is a small price for the public to pay if the seller thereby is stimulated to bring in additional supplies before the acute stage of famine is reached. . . .

"If you fix an arbitrary price, there may be a permanent scarcity, where some of those who most want a thing will not get it at all. If you let the price fix itself, the men who want it most get the thing for the moment, while the producers who charge unfair profits soon find the price reduced to the level of cost of production by the competition of others who enter the same line of business. . . . Instead of saying that a just price was one that conformed to the cost of production, they (the followers of Adam Smith) said that a just price was one that was obtained under fair competition in an open market. The competition of producers prevented it from getting too high; the competition of consumers prevented it from getting too low. The net result was a price that better met the necessities of society than any other; and the trader, as long as his actions were fair and above board, did a public service by producing this competitive market price which fully warranted him in pocketing any he could get. In the eyes of those who held this view, any price which could be thus obtained, without fraud or concealment, was of itself a fair price."[3]

For convenience President Hadley's argument may be summed up as follows: (1) You cannot charge more than the commodity will bear. But if this price falls below cost on some articles, you must make up the deficiency by charging extra prices on other commodities that will bear them. (2) A fixed price conforming to cost may result in waste and scarcity. But this is avoided by leaving the price free since it necessitates thrift and increased production. (3) Under a fixed price, people who most want a thing often fail to get it, while under a free price they are able to get it by paying the price. (4) A price determined naturally in an open competitive market is just, since if one merchant charges extortionately, his competitor promptly undersells him. (5) Therefore, prices and production, if left to themselves, produce far more favorable results to society than a system of control according to some imaginary standards of justice.

The soundness of this argument for the natural and automatic justice resulting from the competitive system depends altogether upon the truth of the underlying assumptions, namely, those of fair competition and an open and free market. With reference to the open market it assumes a free flux and change of all the factors of industry. If the laborer is engaged in an industry in which there is an over-production, he is free either to withdraw or to change to an industry in which there is a scarcity of production. Similarly, the

[3] *Standards of Public Morality*, pp. 37-43.

capitalist can either shut down his plant or take up another line of manufacturing, and the land-owner can either withdraw his land or begin growing crops in which production is scarce. That is to say, a laborer is free to stop coal-mining and promptly begin work either as a baker or an engineer or as a skilled mechanic in a steel plant. The rolling mills in steel could stop turning out steel rails and begin the manufacture of shoes or lumber.

Not only is such a perfect flux required to make the system always yield natural prices but also a pre-knowledge of all the conditions and factors that bring about changes in the market price. For example, if there were going to be a dry season in Western Canada, during the next year and a favorable season in Southern Russia, the Russians, in order to avoid scarcity in the wheat market, would have to know this fact and bring a greater number of fields under cultivation, and the Canadians would have to know it so as to avoid an over-supply of labor and a useless putting out of crops. The over-supply of labor in Canada would either have to move to Russia or find employment in other industries in which there would be a scarcity of production. In fact, nothing short of an absolute knowledge of the world would satisfy the necessary conditions.

It is well known that this mobility with respect to industry does not exist. There is an element of permanency to be considered. In the laborer it is habit; in the capitalist, the fixity of machinery; and in land, the nature of soil in the relation to the seasons of the year. The laborer cannot change and train his habits for a new trade and in the meantime support his family; nor is he free to withdraw his labor, for he usually has no surplus. The capitalist cannot shut down his plant for a very long time without infringing upon his dividends and credit. Nor can the land-owner usually forego his rent without some injury or failure in his business relations. So far, then, as there is permanency in any of the factors of industry, the natural or fair price in an open competitive market will not be obtained. So if there is a scarcity in wheat, it will probably be a year before the production will be increased. If it is in steel, or in coal, the scarcity may never be remedied, for no more mines may be available to new competitors. In such a case, the market price could always be maintained above Adam Smith's natural price.

In this view, then, the assumption of the free mobility of the factors of industry is taken with too much extravagance and in so far invalidates the natural and automatic justice of the competitive system. There is an equal extravagance with regard to the assumption of fair competition. For competitors fair competition obtains when the rules and opportunities under which they operate, apply equally to all. It is not so important what the rules are as it is to have them affect each alike. We have seen that there are many ways in which this condition is violated. The combination can start a siege of price-cutting upon a small trader and wholly destroy his business by spending only a small part of its capital. Because of its ability to supply the carrier with a large and regular traffic, it can obtain a rebate large enough to cover the small shipper's profit and so close the market against him. Because of its extensive capital and organization, it can carry on a system of espionage by which railroad and competitors' employees are paid for furnishing information about the small trader's business, through which information it can go to the competitor's customer and get his trade either by offering lower prices or even by giving the goods gratis; or, if it has a monopoly on some goods which the customer must have, by refusing to trade with him at all unless he ceases to patronize competitors; or, if the customer is a small dealer, by threatening to open competition with him and ruin his business. The combination can also promote its own business and injure that of a competitor through improper use of the press and through questionable advertising. It can furnish editors with editorials which discount the wares of the competitor and praise the merits of its own, or it can cause advertising to the same effect to be printed in the reading columns in the form of disinterested news. It can also go before a legislative body and often by means of its capital alone secure legislation favorable to itself but unfavorable to competitors; or it can employ able lawyers and solicitors who, through their persuasion often secure the same sort of legislation. And with respect to matters in the courts it is well known that the combination can gain much through delays and appeals which are quite impossible to small traders. In these and many other ways the combination can carry on competition from which the small trader is almost wholly deprived because of his small capital. But this competition is bound ere long to prove fatal to his business.

It is seen, therefore, that there are competitive methods and privileges which do not affect all traders alike. On the contrary, they close the market to the small trader and bring monopoly to the combination. The fair competition in an open market which the classical economists and their followers suppose will naturally bring a fair price is quite fallacious; for as soon as the competitors become unequal fair competition comes to an end.

Since, therefore, both the assumptions of the free mobility of the factors of industry and of fair competition in an open market are fallacious, it follows that the fair price which these conditions are supposed to yield is a fiction. It would, however, be unfair to both Adam Smith and President Hadley to say that they failed to recognize this fiction under conditions of monopoly. The error is that President Hadley supposes fair competition to prevail generally while monopoly is the exception.

Let us suppose that the combination, because of its carrying on competition in ways that are not open to the small trader, establishes a monopoly. What then happens to the price? The combination still supposes that charging all it can get brings a fair price. The consumer is not compelled to buy. If then the combination is willing to sell at a given price and the consumer is willing to pay that price, the result is a fair price. Even if the price is more than twice above cost the consumer is still not overcharged for he was willing to pay the price asked. This is the point of view taken by the combination. Undoubtedly a contract made between two reasonable beings is fair, *provided they are equally dependent upon each other.* The question is then whether the monopolist and the consumer *are* equally dependent upon each other. The monopolist must, of course, sell his goods in order to make profits. He cannot sell them for more than they will bear. But his business is not dependent upon any one individual's purchase. So what independence the individual purchaser has is limited by the number of his alternatives, that is, the number of substitutes which he has for the goods which the monopolist sells. If the monopolist is a carrier to a central market from a point where the only important produce is wheat, it is clear, as we have pointed out before, that the farmer's alternatives are few, that his profits will depend upon the carrier's rates, and that the carrier can dictate to the former in what proportion he shall divide his profits with him. If wheat sells for 80 cents per bushel at the central market and 15 cents per bushel is a fair rate for the carrier, that is, a rate high enough to permit him to conduct an efficient business, then the farmer should receive 65 cents for his wheat. But the carrier may raise his rate to 30 cents and reduce the farmer's price to 50. The farmer is still compelled to sell at 50 and pay the carrier 30 for the grain is useless in his granary and he has no other way of disposing of it. He must therefore sell in order to be able to purchase goods needed, such as farm implements, clothing, and books. Where, then, the carrier has a monopoly, he can determine in what proportion the shipper shall divide his profits with him. Again, suppose the monopolist is a manufacturer of gas in a city. Previous to the monopoly there was competition in the gas business and consumers received rates of 75 cents per 1,000 feet. But this did not yield an average profit upon the investment. The result was a combination and the rates raised to $1.25. During the competitive régime consumers found gas a cheaper and more convenient fuel than any other materials. Accordingly, they discarded all their stoves and furnaces and had their houses supplied with gas fittings. In this way gas became organized as a necessary element in the consumers' lives so that it was impossible to dispense with it without great inconvenience. Consequently, the consumer will pay the high rate, although with reluctance and complaint. But a rate of 80 cents may be enough to enable the monopolist to carry on a flourishing business and pay a good return upon his investment. The extra 45 cents must, therefore, be looked upon as a tax which the manufacturer is able to levy because of his power of monopoly. Again, the monopolist is able to compel the consumer to divide his earnings with him. To bring out the point more clearly, we may cite the classic example of the baker's monopoly. A starving man with a dollar in his pocket has the alternative of parting either with his life or with his dollar for a loaf of bread. He chooses to spend his dollar, although five cents would have been enough for the baker.

From these illustrations it is clearly seen that when a trader once has a monopoly upon a useful commodity, the equal dependence between seller and buyer is destroyed. The buyer has lost the alternative of competition which prevented him from being over-charged and he is unable to find substitutes which are equally as good and cheap as the monopolist's products. So long, therefore, as the monopolist is left to bargain individually with each consumer, there is no equality and a free and fair contract is impossible. To make the monopolist and the consumer equally dependent upon each other, all the consumers must combine and bargain collectively with the monopolist or combination of traders. The monopolist then must sell to this combination of consumers in order to realize any profits, and he must sell at such prices as the consumers think reasonable. The consumers would pay a price sufficient to enable the monopolist to carry on a flourishing business and receive an average return upon his capital, for otherwise they could not get the monopolist's goods in the quantity and quality in which they want them. In this way alone can the consumer bargain fairly with the monopolist.

But then there is the practical problem of forming a combination among the consumers, for in not a few cases the consumers are scattered over an entire nation and, in some, over many nations. It is unnecessary that the consumers of separate nations combine, for as yet there is no combination of manufacturers with which a single nation cannot deal fairly and equally. But the consumers of a given nation are already combined and have an organization in the State. Their recourse is then to have the State bargain in their behalf with the monopoly. There are many reasons for making this arrangement. Only the State can bargain fairly with the combination. The State protected consumers against unreasonable prices in allowing traders to freely compete with each other. It allowed traders to charge all they could get, for in an open market under fair competition they could not get too much. But competition often became too strong and caused too many traders to fall into brankruptcy. To avoid this, the State allowed traders to combine for regulating production and prices. This made possible unequal competition between the combination and the small trader. The State failed to prevent this and the result was monopoly. The monopoly still kept on charging all it could get. But charging all it could get in a closed market under no competition proved to be extortion to the consumer. To prevent this, the State should again resume its protection of the consumer, not necessarily by reintroducing competition, but by regulating the monopoly. It should do this not only because of its former protection of the consumer against unfair prices, but also because, if it protects the trader against the wastes of competition and of unregulated production, it should treat the consumer equally well by protecting him against the extortion of monopoly.

I believe the justness and fairness of this reasoning and conclusion to be indisputable. Charging all you can get in an open market under fair competition brings fair prices. But charging all you can get in a closed market under no competition is extortion just as taxation without representation is tyranny. Even under competition, charging all you can get is not fair unless the competition is fair and affects all traders alike, large or small; for just in so far as competition is unequal, and just in so far as a trader enjoys monopoly, he can charge unreasonable prices. If the State, then, relies upon competition to bring justice to the consumer, it should undertake to make competition fair and make the "rules of the game" apply equally to all. But if it allows monopoly, then it is obliged to regulate it. All the arguments against State interference with the course of trade, however applicable to conditions of fair competition, lose all their force as applied to monopoly; for, under monopoly, prices and production are no more free and left to adjust themselves. On the contrary they are fixed and regulated by the monopolist. The consumers or people then have to choose between a price as fixed by the monopolist, who regulates the price primarily with reference to his own interests, and a price as fixed by an intelligent Public Service Commissioner, who regulates prices with reference to the interests of all, both consumer and producer. To suppose that an intelligent and disinterested commissioner could not do as well as a self-interested monopolist is presumptuous and requires proof, especially in view of the success of some present-day Public Service Commissions. To recite the failures and disasters of mediæval regulation is no argument; for the mediæval idea of a fixed price, which did not recognize changes required by new conditions, is not necessarily adopted by a modern commission which does recognize such changes. Moreover, in medieval times the judge thought it sufficient to fix prices without interfering with production, and this was the cause of his failure. But in the present day we are in control of both production and prices, and, therefore, conditions are favorable for the success of public regulation.

Looking back over our argument, I believe we may safely conclude that the methods of charging common between individual traders in competition cannot be adopted without change by combinations or monopolies. Such an adoption is just as disastrous to the consumer as are the methods of individual competitors to the small trader when played against him by the combination. To insure the consumer as fair dealing under conditions of monopoly as he received from individual traders in competition, the State must directly regulate the monopoly. That is to say, under these conditions we must abandon the view that the business of a large industrial combination is a matter of private interest and private law, and on the contrary, we should treat them as public service corporations required to operate under the laws governing a business of that nature. The judicial and legal problem will be solved by applying to manufacturing and marketing concerns the principles now applied to railroads.

SUMMARY

In regard to the character of morals, we noticed that the phase of morality, constituted by judicial law, is a matter of growth and evolution. The growth is occasioned by a change in the environment or situation in which the laws are designed to function. When such a change occurs, the old rule is at first generally applied to the new situation without alteration. After it is discovered that the results are unsatisfactory, then a change in the rule is proposed giving rise to a conflict between old and new rules. This usually takes place between two types of judges, namely the conservative and the liberal. The conservatives ignore the changed conditions and are governed principally by precedent. They merely consider whether the act in question was forbidden in the past, and, if it was not, they argue in a syllogistic fashion, without examining the grounds of their premises, that the act is lawful. The liberals, on the other hand, take account of the changed conditions and are governed primarily by the facts of the case. Precedent failing them, they appeal to the public interest which they consider the criterion of authoritative law. In formulating a new rule, they use functional and inductive logic as against the syllogistic. It is this which enables them to construct and reach a new conclusion.

The changing character of morals is nowhere more conspicuous than in those of monopoly and competition.

Competitive morals grew out of previous monopolistic conditions and were approved because they better satisfied the public interest, and, on the whole, were worth more to society than they cost. They functioned satisfactorily so long as industrial conditions were genuinely competitive and individual traders were approximately equal in capital. Because of this, they in course of time were definitely crystallized into the common law. But, when large combinations were introduced and continued the customs of individual traders, competitive morals made the capital of the combination the principal element of success, enabled it to crush small traders and establish a monopoly which was not in the interest of the public. This result was first observed in the case of the railroads which were in consequence removed from the concept of private law and private business to the concept of public law and public business, and accordingly required to conduct their business impartially and without discrimination. Manufacturing and marketing combinations are now passing through the same stage. I believe our analysis has shown that their business is essentially public in character, and, that if the interests of the consumer are to be as well protected as under the old competitive régime, these large industrial combinations must be treated as public service corporations governed by public law instead of by private law. The fact that they now operate under private law is the principal cause of our present industrial problems.

As business conditions change from the private, individual, and competitive system to the public, combinational, and monopolistic system, there must be a corresponding change in the working principles from charging what the commodity or traffic will bear to charging prices and rates yielding a fair profit over cost of production or service. In general, this is a change from charging *all you can get* to charging only what is *needed* for conducting an efficient business.